

UNITED STATES MARINE CORPS

2017



FISCAL YEAR 2017 AGENCY FINANCIAL REPORT

Semper Fidelis

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Practicing precision drill movements during a portion of a month-long training phase. (U.S. Marine Corps photo by Cpl. Robert Knapp/Released)

## TABLE OF CONTENTS

### SECTION 1: MANAGEMENT’S DISCUSSION & ANALYSIS 2

Mission and Organizational Structure . . . . .	3
Analysis of Performance Goals, Objectives, and Results. . . . .	11
Analysis of Financial Statements and Stewardship Information . . . . .	11
Analysis of Systems, Controls, and Legal Compliance . . . . .	14
Limitation of Financial Statements . . . . .	17

### SECTION 2: FINANCIAL SECTION 18

Message from Fiscal Director of the Marine Corps . . . . .	19
Office of Inspector General Transmittal. . . . .	21
Independent Auditor’s Report . . . . .	23
Response to Independent Auditors’ Report. . . . .	79
Principal Financial Statements . . . . .	81
Notes to Principal Financial Statements . . . . .	86
Required Supplementary Stewardship Information . . . . .	120
Required Supplementary Information. . . . .	122

### SECTION 3: OTHER INFORMATION 128

Summary of Financial Statement Audit and Management Assurances . . . . .	129
Payment Integrity. . . . .	130
Fraud Reduction Report . . . . .	132
Reduce the Footprint . . . . .	132
Acronyms. . . . .	134



## **SECTION 1:** Management's Discussion & Analysis



*An Amphibious Assault Vehicle launches into the water to perform amphibious breaching operations. (U.S. Marine Corps photo by Cpl. Ashley Lawson)*

On November 10, 1775, the Second Continental Congress established the United States Marine Corps (USMC or Marine Corps), which has since served in nearly every military conflict in United States history. Its ability to rapidly respond on short notice to expeditionary crises has made and continues to make it an important tool for American foreign policy. Carrying out duties given to them directly by the President of the United States, USMC serves as an all-purpose, fast-response task force, capable of quick action in areas requiring emergency intervention.

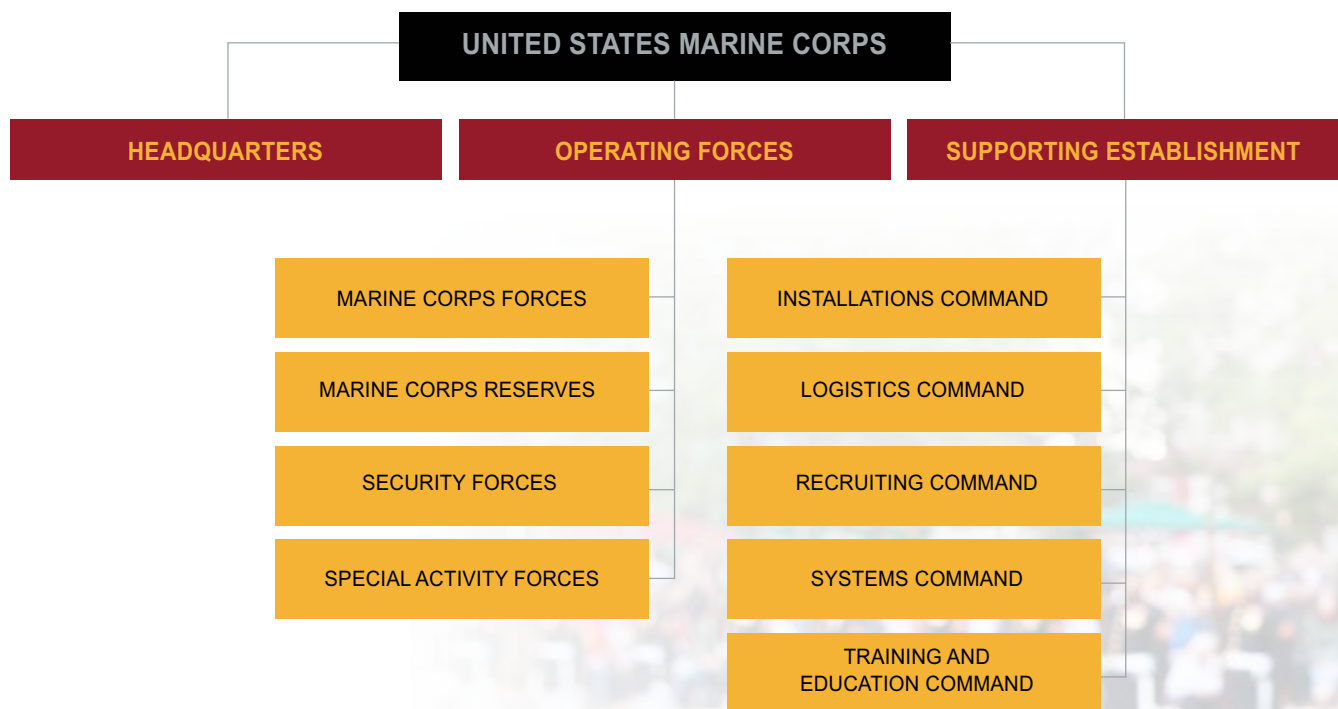
Marine tactics and doctrine tend to emphasize aggressiveness and the offensive. USMC has been central in developing groundbreaking tactics for maneuver warfare and can be credited with the development of helicopter insertion doctrine and modern amphibious assault. As a force, Marine Corps consistently uses all essential elements of combat (air, ground, sea) together, a trademark that allows the Marines to maintain integrated, multi-element task forces under a single command, bringing flexibility and lethality to ever-changing threats.

## MISSION AND ORGANIZATIONAL STRUCTURE

### MISSION

After World War II, Congress codified the roles and missions of USMC in the *National Security Act of 1947*, which include:

- Seizing or defending advanced naval bases and to conduct such land operations as may be essential to the prosecution of a naval campaign;
- Providing detachments and organizations for service in armed vessels for the Navy or for the protection of naval property on naval stations and bases;
- Developing with the other armed forces, tactics, techniques, and equipment employed by landing forces in amphibious operations;
- Training and equipping Marines, as required, for airborne operations;
- Developing with other armed forces, doctrine, procedures, and equipment for airborne operations; and
- Expanding from peacetime components to meet the needs of war in accordance with mobilization plans.



**FIGURE 1. USMC ORGANIZATION STRUCTURE**

## ORGANIZATIONAL STRUCTURE

USMC is a component reporting entity of the U.S. Department of the Navy (DON), led by the Commandant of the Marine Corps (CMC) and, ultimately, the Secretary of the Navy. USMC is funded primarily through direct appropriations and appropriations shared with the DON. Budget requests and funding decisions for USMC are made at the DON level, in consultation with the USMC and in consideration of USMC funding recommendations.

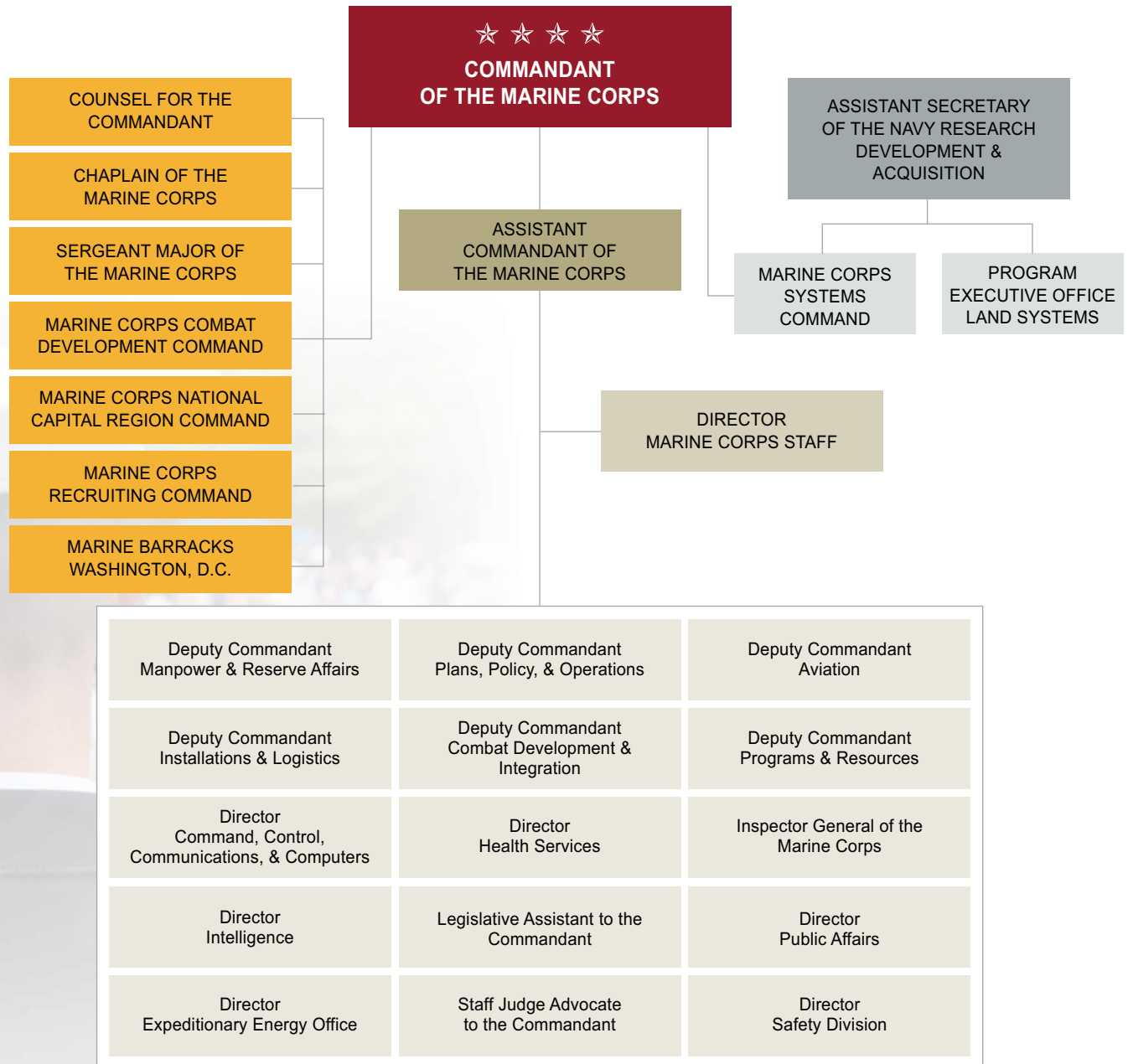
Existing to fully support the larger DON mission, the USMC currently consists of Active Duty Marines, Select Reserve Marines, and Inactive Ready Reserve. At any given time, Marines are deployed in operations supporting our Nation's defense.

USMC is divided into Headquarters, the Marine Corps Operating Forces, and the Supporting Establishment.

### Headquarters, U.S. Marine Corps

Headquarters, U.S. Marine Corps (HQMC) consists of the CMC and those staff agencies that advise and assist him in discharging his responsibilities prescribed by law. This includes the administration, discipline, internal organization, training, requirements, efficiency, and readiness of the service. The Commandant is also a member of the Joint Chiefs of Staff, and HQMC supports him in his interaction with the Joint Staff. HQMC is spread throughout the Washington, D.C. metro area, including locations at the Pentagon, Marine Barracks Washington, D.C., Marine Corps Base Quantico, and the Washington Navy Yard.

The components of USMC Headquarters are included in the following organization chart:



**FIGURE 2. HQMC ORGANIZATIONAL STRUCTURE**

## Marine Corps Operating Forces

USMC operating forces maintain a constant state of readiness through an organizational structure that enables rapid, global response by air, land, and sea. As noted in Figure 1, the operating forces are sub-divided into four categories: Marine Corps Forces, including all Marine ground, aviation, and combat logistics; Marine Corps Reserves, who support the Active Component by fielding deployable units; Security Forces, which protect key installations, vessels, units, and assets of the United States

Government; and Special Activity Forces, who guard United States embassies and foreign posts.

USMC established U.S. Marine Corps Forces Command (MARFORCOM), U.S. Marine Corps Forces, Pacific (MARFORPAC), and U.S. Marine Corps Forces, Special Operations Command (MARSOC) as permanent commands to provide forces to unified combatant commanders. Marine forces are apportioned to the remaining geographic and functional combatant commands — the U.S. Southern



Command (SOUTHCOM), U.S. Northern Command (NORTHCOM), U.S. European Command (EUCOM), U.S. Central Command (CENTCOM), U.S. Africa Command (AFRICOM), U.S. Strategic Command

(STRATCOM), U.S. Cyber Command (CYBERCOM), and U.S. Forces Korea (USFK) — for contingency planning and are provided to these commands when directed by the Secretary of Defense.

### U.S. MARINE CORPS FORCES COMMAND



Located in Norfolk, Virginia, MARFORCOM is tasked with commanding the Active Component operating forces; executing force sourcing and synchronization to provide joint commanders with the Marine Corps forces they require; directing deployment planning and execution in support of combatant commander and service requirements; serving as Commanding General, Fleet Marine Forces Atlantic, and commanding embarked Marine Corp forces; coordinating USMC-Navy integration of operational initiatives and advising the Commander, U.S. Fleet Forces Command, on Navy support to Marine Corps forces assigned to naval ships, bases, and installations.

### U.S. MARINE CORPS FORCES, PACIFIC



MARFORPAC has three command roles and responsibilities. The command serves as USMC component to U.S. Pacific Command (USPACOM), USMC component to USFK, and Fleet Marine Forces Commander to Pacific Fleet. In addition to its service component responsibilities, MARFORPAC could be tasked to act as a joint task force command element. With its headquarters located at Camp H. M. Smith, Hawaii, MARFORPAC is the largest field command in the USMC, having control of two-thirds of USMC operational forces. Commander, MARFORPAC commands all USMC forces assigned to USPACOM operating in a diverse geographic area stretching from Yuma, Arizona to Goa, India. The Commander, MARFORPAC supports national and theater strategic objectives, and exercises USMC component responsibilities in support of operational and concept plans, theater security cooperation, foreign humanitarian assistance, homeland defense, and force posture.

### U.S. MARINE CORPS FORCES, SPECIAL OPERATIONS COMMAND



MARSOC is the USMC service component of U.S. Special Operations Command (USSOCOM), and is tasked by the commander of USSOCOM to train, organize, equip, and when directed by commander of USSOCOM, deploy task organized, scalable and responsive U.S. Marine Corps Special Operations Forces worldwide in support of combatant commanders and other agencies. MARSOC conducts foreign internal defense, special reconnaissance, and direct action. Commander, USSOCOM assigns MARSOC missions based on USSOCOM priorities. MARSOC units deploy under USSOCOM deployment orders.

### U.S. MARINE CORPS FORCES RESERVE



Headquartered in New Orleans, Louisiana, U.S. Marine Corps Forces Reserve (MARFORRES) is responsible for providing trained units and qualified individuals for active-duty service in times of war, national emergency, or in support of contingency operations. USMC force expansion is made possible by activation of the Marine Corps Reserve. As an operational reserve, MARFORRES provides personnel and operational tempo relief for active component forces during times of peace. Like the active component, MARFORRES is a combined-arms force with balanced ground, aviation, and logistics combat support units. MARFORRES capabilities are managed through MARFORCOM as part of its global force management responsibilities for the Commandant. MARFORRES has units located all over the United States and in Puerto Rico.



### **U.S. MARINE CORPS FORCES, CYBERSPACE COMMAND**



Marine Corps Forces Cyberspace Command (MARFORCYBER), located at Fort Meade, Maryland, is the USMC service component for CYBERCOM. MARFORCYBER enables full spectrum cyberspace operations, to include the planning and direction of Marine Corps Enterprise Network Operations, defensive cyberspace operations in support of USMC, Joint and Coalition Forces, and the planning and, when authorized, direction of offensive cyberspace operations in support of Joint and Coalition Forces, in order to enable freedom of action across all warfighting domains and deny the same to adversarial forces.

### **U.S. MARINE CORPS FORCES SOUTH**



U.S. Marine Forces South (MARFORSOUTH), located in Miami, Florida, is the USMC service component for SOUTHCOM. MARFORSOUTH commands all USMC forces assigned to SOUTHCOM and advises the Commander, SOUTHCOM on the proper employment and support of Marine forces; conducts deployment and redeployment planning and execution of assigned, attached Marine forces; and accomplishes other operational missions as assigned.

### **U.S. MARINE CORPS FORCES NORTHERN COMMAND**



Co-located with MARFORRES in New Orleans, Louisiana, U.S. Marine Forces North executes antiterrorism program and force protection responsibilities; plans for the use of Marine forces and advises on the proper employment of USMC forces; coordinates with and supports USMC forces when attached to NORTHCOM within NORTHCOM's area of responsibility in order to conduct homeland defense operations and provide defense support to civil authorities.

### **U.S. MARINE CORPS FORCES, CENTRAL COMMAND**



Marine Corps Forces Central Command (MARCENT) is located on MacDill Air Force Base, Florida and is designated as the USMC service component for CENTCOM. MARCENT is responsible for all Marine forces in the CENTCOM area of responsibility. MARCENT provides Marine Expeditionary Forces capable of conducting a wide range of operations, offering the command a responsive and unique set of capabilities. Marines deployed in support of ongoing operations, as well as embarked aboard U.S. Navy amphibious ships provide a potent mix of capabilities that can project combat power rapidly to any location in the region.

### **U.S. MARINE CORPS FORCES, AFRICA AND U.S. MARINE CORPS FORCES, EUROPE**



Headquartered in Stuttgart, Germany, USMC Forces, Europe and USMC Forces, Africa provide support to USMC deployed rotational units and the EUCOM and AFRICOM commanders across all warfighting functions. Planning efforts from this headquarters translate strategic objectives into operational objectives through operations using such forces as Special Purpose Marine Air Ground Task Force Crisis Response-Africa and the Black Sea Rotational Force.

## U.S. MARINE CORPS FORCES, STRATEGIC COMMAND



Marine Corps Forces Strategic Command (MARFORSTRAT) is co-located with Headquarters, STRATCOM at Offutt Air Force Base, Nebraska. MARFORSTRAT is the USMC service component command to STRATCOM and represents USMC capabilities and interests, and advises Commander, U.S. Strategic Command on proper employment and support of Marine forces. Advises and assists other USMC commands and supporting establishment in the development of concepts, education, training, doctrine, and capabilities in space, cyberspace, electronic warfare, and combating weapons of mass destruction operations and planning, and advocates for capabilities in order to ensure coherent cross mission situational awareness and integration between the USMC and STRATCOM.

## U.S. MARINE CORPS FORCES, KOREA



USMC Forces Korea (MARFORK), located in Seoul, South Korea, is the USMC service component for USFK and United Nations Command (UNC). It commands all USMC forces assigned to USFK and UNC; advises USFK and UNC on the capabilities, support, and proper employment of Marine forces; and supports the defense of the Republic of Korea (ROK) by facilitating the rapid introduction of USMC forces onto the Korean Peninsula in order to maintain stability in Northeast Asia. Additionally, MARFORK is the USMC representative to the Commandant of the ROK Marine Corps.

## MARINE CORPS SECURITY FORCE REGIMENT



Located in Yorktown, Virginia, the USMC Security Force Regiment (MCSFR) provides limited duration expeditionary anti-terrorism and security forces in support of designated component and geographic combatant commanders in order to protect vital naval and national assets. MCSFR conducts other limited duration contingency operations as directed by the commander of MARFORCOM. Mission-essential tasks include: (1) providing forward deployed, expeditionary anti-terrorism and security forces to support designated commanders, and protect vital national assets; (2) providing expeditionary antiterrorism and security forces, deployable from the United States, to establish or augment security as directed by the commander of MARFORCOM; and (3) maintaining permanent forces to provide security for strategic weapons at designated facilities.

## MARINE CORPS EMBASSY SECURITY GROUP



The Marine Corps Embassy Security Group (MCESG) is located on Marine Corps Base Quantico. MCESG provides protection to embassy and consulate personnel and prevents the compromise of national security information and equipment at designated diplomatic and consular facilities. Marine Security Guards are prepared to execute plans for the protection of the mission and its personnel, as directed by the chief of mission or principal officer through the regional security officer.

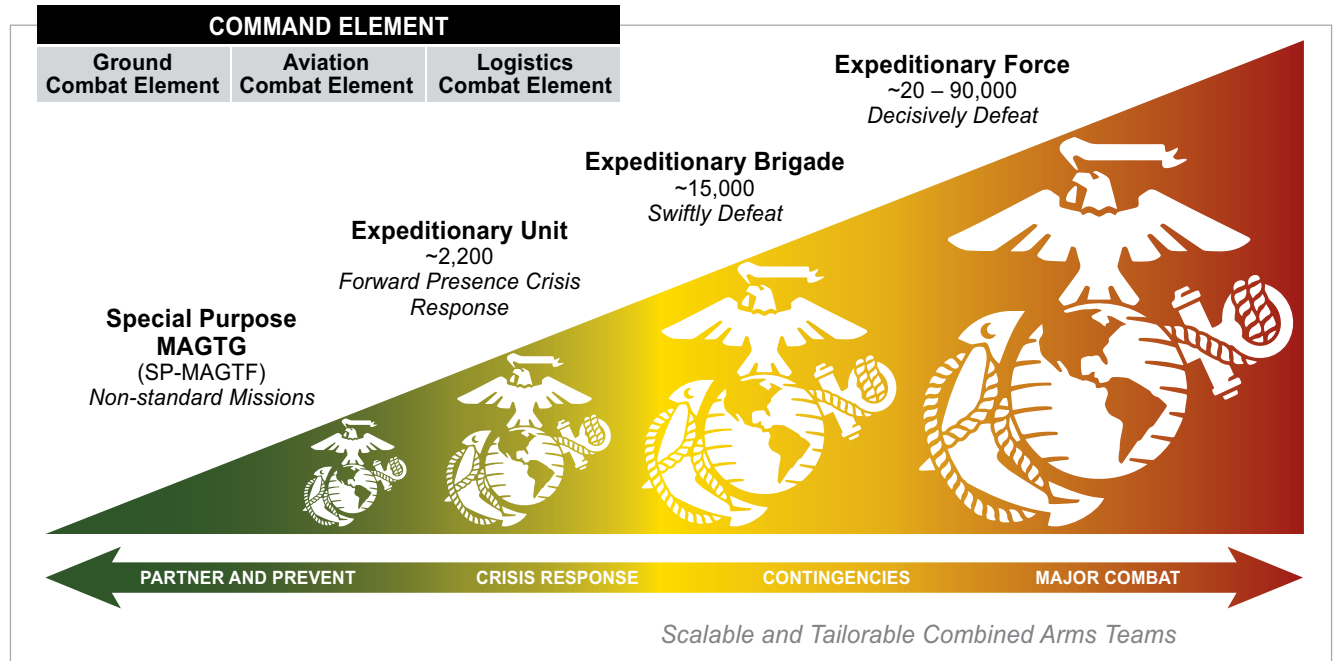
## Marine Air-Ground Task Force

The Marine Air-Ground Task Force (MAGTF) is the USMC's principal organizational construct for conducting missions across the range of military operations. As highlighted in Figure 3, MAGTFs provide combatant commanders with scalable, versatile expeditionary forces able to assure allies, deter potential adversaries, provide

persistent U.S. presence with little or no footprint ashore, and respond to a broad range of contingency, crisis, and conflict situations. They are balanced combined-arms force packages containing command, ground, aviation, and logistics elements. A single commander leads and coordinates this combined-arms team through all phases

of deployment and employment. MAGTF teams live and train together, further increasing their cohesion and fighting power. Tailored to meet combatant commanders' requirements, MAGTFs operate as an integrated force

in the air, land, maritime and cyberspace domains. The naval character of MAGTFs enhances their global mobility, lethality, and staying power.



## TYPES OF MAGTFs

### Supporting Establishment

The supporting establishment includes all bases, air stations, and installations. They assist in training, sustainment, equipping, and embarkation of deploying Marine Forces.

#### MARINE CORPS INSTALLATIONS COMMAND



Marine Corps Installations Command (MCICOM) is the single authority for all installation matters. MCICOM consists of a headquarters and four subordinate commands: Marine Corps Installations Pacific, Marine Corps Installations West, Marine Corps Installations East, and Marine Corps Installations National Capital Region. The forces assigned to MCICOM provide timely support to the Marines, Sailors, and families from the operating forces and maintenance depots. They are essential components in the foundation of national defense as they are the force projection platforms that support training, sustainment, mobilization, deployment, embarkation, redeployment, reconstitution, and force protection.

#### MARINE CORPS LOGISTICS COMMAND



Headquartered in Albany, Georgia, Marine Corps Logistics Command (MCLC) provides worldwide, integrated logistics, supply chain, and distribution management; maintenance management; and strategic prepositioning capability in support of the operating forces and other supported units. The services and support provided by MCLC maximize supported unit readiness, synchronize distribution processes, and support USMC enterprise and program-level total lifecycle management.



MCLC is structured to execute its core competencies via its four subordinate commands, its Marine Expeditionary Forces (MEF) Support Teams co-located with each MEF and Marine Forces Reserve Headquarters, and its liaison officers in the National Capital Region, at Marine Corps Systems Command, and the Program Executive Office-Land Systems.

### **MARINE CORPS RECRUITING COMMAND**



Headquartered at Marine Corps Base Quantico, VA, the USMC Recruiting Command is responsible for military recruitment of civilians into the USMC. The primary objective is the perpetuation of the USMC and the standards of preparedness and military vigor that Marines have upheld since 1775. The immediate impact that recruiting has on the USMC requires that standards for enlistment be strictly set to ensure that future Marines will maintain our tradition of excellence. Accordingly, the mission of the USMC is to “Make Marines, Win Battles, and Return Quality Citizens” to their communities.

### **MARINE CORPS SYSTEMS COMMAND**



Headquartered at Marine Corps Base Quantico, VA, the Marine Corps Systems Command (MCSC) is the CMC’s agent for acquisition and sustainment of systems and equipment used to accomplish their warfighting mission. The command outfits Marines with literally everything they drive, shoot, and wear. MCSC is the only systems command in the USMC, and serves as the Head of Contracting Authority. MCSC exercises technical authority for the full spectrum of all USMC ground weapon and information technology programs for current and future expeditionary and crisis-response capabilities.

### **MARINE CORPS TRAINING AND EDUCATION COMMAND**



Headquartered at Marine Corps Base Quantico, VA, the mission of the Marine Corps Training and Education Command is to develop, coordinate, resource, execute, and evaluate training and education concepts, policies, plans, and programs to ensure Marines are prepared to meet the challenges of present and future operational environments.





Marines deliver synchronized fire in their M1A1 Abrams tanks during a fire mission. (U.S. Marine Corps photo by Pfc. Taylor Cooper)

## ANALYSIS OF PERFORMANCE GOALS, OBJECTIVES, AND RESULTS

The USMC has not yet begun to develop a comprehensive entity-wide strategic plan and prepare annual performance plans, and therefore, does not develop related performance goals, objectives, and results in accordance with the Government Performance and Results Act. Instead, the current governance is based off of Commandant's Planning Guidance issued periodically

at the discretion of the Commandant to address the operational needs of the USMC. The Commandant's Planning Guide is a high level vision statement that outlines his objectives during his tenure. As part of the Department of the Navy, the Marine Corps contributes to the achievement of goals in the Department of the Navy strategic plan.

## ANALYSIS OF FINANCIAL STATEMENTS AND STEWARDSHIP INFORMATION

### Balance Sheet

The significant asset line items to USMC include Fund Balance with Treasury (FBWT), Inventory and Related Property, and General Property, Plant, and Equipment.

The significant liability line items to USMC include Accounts Payable (non-federal), Environmental and Disposal Liabilities, and Other Liabilities (non-federal).

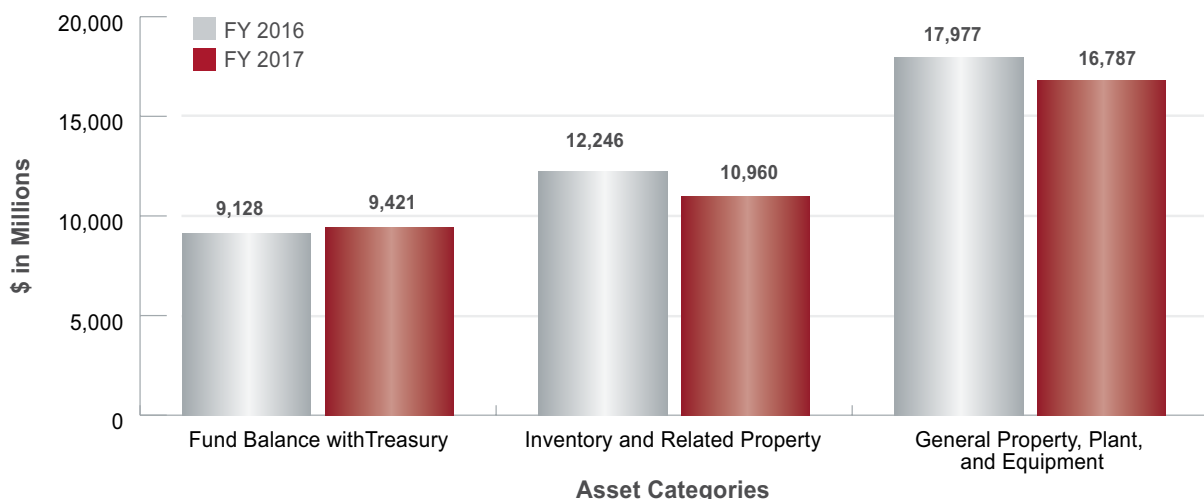


CHART 1: BALANCE CHANGES IN SIGNIFICANT ASSET LINE ITEMS

FBWT on the balance sheet remained relatively consistent between the two years. The increase of \$293 million (3%) at fiscal year end (FYE) 2017 compared to FYE 2016 is attributable to the increased funding from Congress.

Inventory and Related Property decreased \$1.3 billion (11%) at FYE 2017 compared to FYE 2016. This decrease is primarily attributed to the adjustments made to the beginning balances of Operating Material and Supplies (OM&S) in FY 2017. The adjustments were made to the non-ammunition category of OM&S as

a result of the inventory counts performed during the current fiscal year. In addition, there was an increase in the consumption of ammunition in FY 2017 to support operational training and overseas contingency exercises and engagements.

General Property, Plant, and Equipment decreased \$1.2 billion (7%) at FYE 2017 compared to FYE 2016. The decrease is due to correction of errors related to the beginning balances and remediation of known deficiencies in reporting General Equipment (GE).

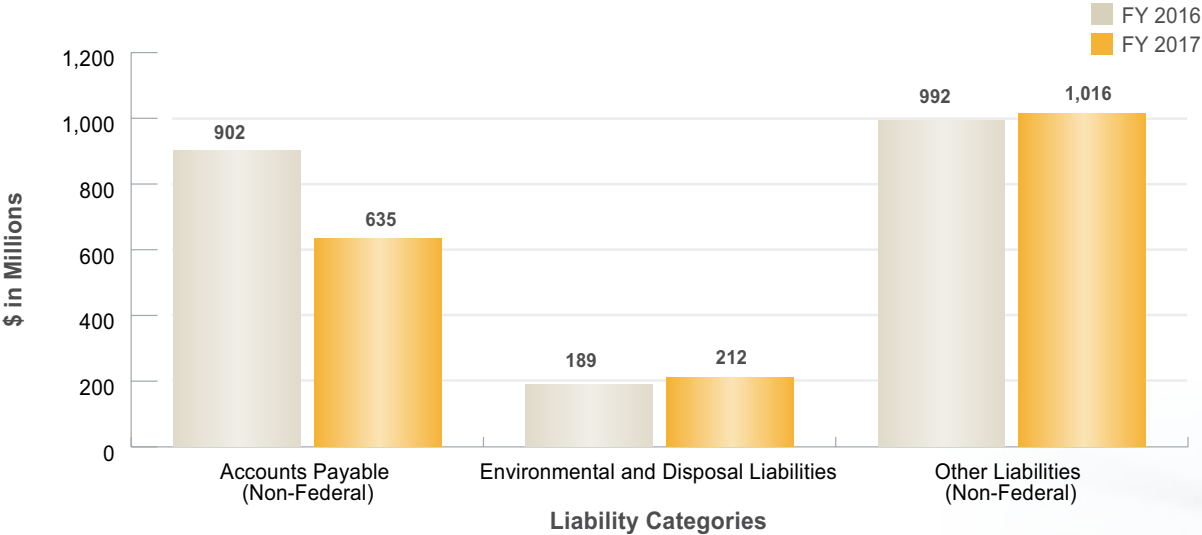


CHART 2: BALANCE CHANGES IN SIGNIFICANT LIABILITY LINE ITEMS

Non-federal Accounts Payable decreased \$267.9 million (30%) at FYE 2017 compared to FYE 2016. The variance is largely the result of a write off of invalid accounts payable related to cancelled appropriations. In contrast, Accounts Payable (Intragovernmental), increased \$27.1 million (16%) at FYE 2017 compared to FYE 2016. The increase is a result of improvements to the accrual estimation methodology that resulted in a more accurate accrual estimate.

Environmental and Disposal Liabilities increased \$22.9 million (12%) in FYE 2017 compared to FYE 2016. This increase results primarily from a \$16.3 million net increase in asbestos reporting due to the addition of liabilities associated with properties identified and captured into the Accountable Property System of Record (APSR) in FY 2017. Additionally, there is a

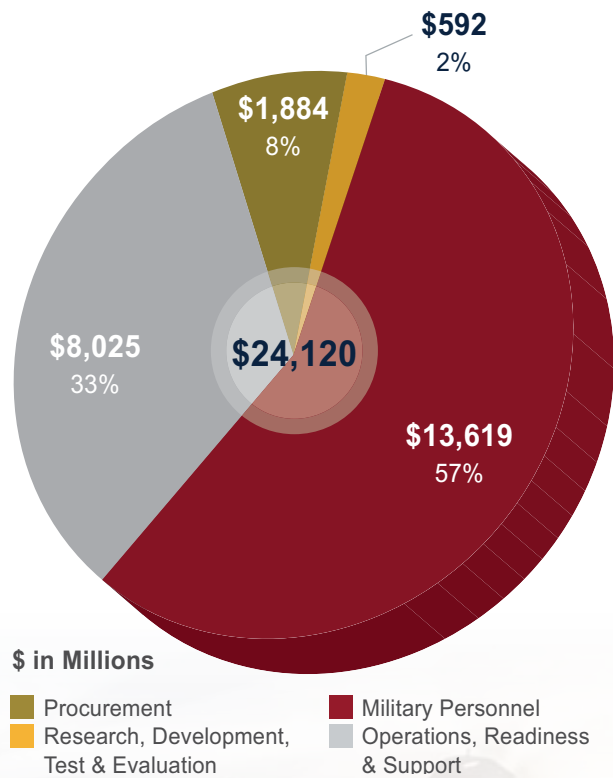
\$9.2 million net increase in Closure: Pre-1998 reporting due to properties identified and added to the APSR and the re-estimation of existing liabilities based on the new cleanup cost estimating business rules.

Combined Statement of Budgetary Resources

The Combined Statements of Budgetary Resources (SBR) provides information on the budgetary resources available to USMC for the year and the status of those resources at the end of the fiscal year. USMC receives most of its funding from general funds administered by the Department of the Treasury (Treasury) and appropriated for USMC’s use by Congress. Since budgetary accounting rules and financial accounting rules recognize certain transactions at different points in time, Appropriations Used on the Consolidated Statements



of Changes in Net Position will not match costs for that period. The primary difference results from recognition of costs related to changes in unfunded liability estimates. Budget authority from appropriations on the Combined SBR increased in FY 2017 by \$1.1 billion from FY 2016 due to increased funding from Congress.



**CHART 3: APPROPRIATIONS RECEIVED**



*Conducting a patrol while in route to a key leader engagement. (U.S. Marine Corps photo by Cpl. Kimberly Aguirre/Released)*



Marines fire their M777 Howitzer during a fire mission. (U.S. Marine Corps photo by Lance Cpl. Zachery Laning)

## ANALYSIS OF SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

Commanders and managers throughout the USMC must ensure the integrity of their programs and operations. Part of this responsibility entails compliance with Federal requirements for financial reporting, financial management systems, and internal controls, such as the *Federal Financial Management Improvement Act* (FFMIA) and the *Federal Managers' Financial Integrity Act* (FMFIA). These requirements promote the production of more timely, reliable, and accessible financial information, supported by the development and implementation of more effective internal controls. Useful financial information and effective controls save money and improve efficiency, thereby enhancing public confidence in our stewardship of public resources, which is critical for the protection and sustainment of our Nation and vital U.S. interests.

### FMFIA ASSURANCE STATEMENT

The Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, Appendix A, provides specific requirements for conducting management's assessment of internal control over financial reporting, and requires the agency head to provide an assurance statement on the effectiveness of controls. The FMFIA assurance statement provides an assessment of the effectiveness of the USMC's internal controls to support effective and efficient programmatic operations, reliable financial reporting, compliance with applicable laws and regulations, and whether financial

The USMC maintains compliance with applicable laws and regulations by requiring Commanders and managers at all levels to establish and continuously maintain an active Managers' Internal Control Program (MICP). The MICP evaluates and reports on the effectiveness of internal controls throughout the organization in order to ensure effective operations, safeguard against fraud, waste and mismanagement, and comply with laws and regulations. Additionally, Commanders and managers at all levels are required to properly integrate risk management practices and internal control functions to effectively and efficiently identify, assess, manage, and report on risks.

management systems conform to financial systems requirements.

The USMC is still in the early stages of implementing a comprehensive Enterprise Risk Management (ERM) capability coordinated with the strategic planning and strategic review process established by the Government Performance and Results Act Modernization Act, the internal control processes required by FMFIA, and the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* (also known as the Green Book). USMC's FMFIA assurance



statement for the period through June 30, 2017 provided a modified assurance on the control effectiveness and listed 16 material weaknesses identified through the existing management internal control assessments. However, the deficiencies reported as material weaknesses require further review by USMC leadership to confirm that they represent material weaknesses at a comprehensive USMC level pertaining to the ERM process that is still in process of being established.

Additionally, the USMC is working to resolve control deficiencies identified during the FY 2014 Schedule of Budgetary Activity audit as described in the Report of Independent Certified Public Accountants issued by Grant Thornton in April, 2015. The status of USMC unresolved material weaknesses related to the prior year audit is as follows:

Material Weakness	Summary Description	Corrective Actions and Status
<b>1. Lack of Marine Corps oversight over Defense Finance and Accounting Service (DFAS)</b>	The material weakness identified that USMC lacked appropriate processes and related controls to provide oversight over the monitoring, reconciliation, and disposition activities performed by DFAS on behalf of USMC within suspense clearing accounts and deposit accounts.	USMC and DFAS are working to identify the high risk areas requiring USMC oversight and updating the service level agreements to capture the roles and responsibilities of both parties. Corrective actions also include the development of review mechanisms such as checklists and certifications to document oversight of DFAS activities performed on behalf of USMC. Corrective actions are estimated to be completed by 4th quarter 2018.
<b>2. Inadequate management review and oversight of Marine Corps' financial reporting</b>	The material weakness identified deficiencies in management's review and oversight over the timely and accurate recording of transactions.	USMC is strengthening controls to improve the accuracy and timeliness over recording obligations in the accounting system. USMC is also implementing oversight controls to confirm compliance with established controls. In addition, USMC is collaborating with Office of the Undersecretary of Defense (OUSD) to implement an Invoice Payment Platform to timely record expenses for intragovernmental purchases in advance of payment. Corrective actions are estimated to be completed by 4th quarter 2018.
<b>3. Improper application of federal accounting standards and guidelines</b>	The material weakness identified that USMC was not in compliance with generally accepted accounting principles (GAAP) and other Federal and U.S. Department of Defense (DoD) regulations and guidance for recording collections from special measure agreements and Materiels Returns Program (MRP) transactions.	While acknowledging that these weaknesses are DoD wide issues, USMC is collaborating with OUSD to obtain accounting guidance and updated policies and procedures to address the GAAP departures when recognizing special measure agreement and MRP specific collections. After obtaining OUSD guidance, USMC will work with feeder system owners to identify required data attributes to allow the core accounting system to properly report the business events in accordance with GAAP. Corrective actions completion timeframe is in process of being established.
<b>4. Invalid authorization of obligations</b>	The material weakness identified that USMC lacked internal controls over the authorization of obligations.	USMC is strengthening controls over the appointment and assignment of personnel who are authorized to obligate on behalf of USMC. USMC is also implementing oversight controls to confirm compliance with established controls. Corrective actions are estimated to be completed by 4th quarter 2018.
<b>5. Inability to maintain adequate documentation</b>	The material weakness identified that USMC did not provide documentation to support selected military standard requisitioning and issue (MILSTRIP) transactions, temporary additional duty travel transactions, collections transactions, obligations transactions and outlays transactions.	USMC is strengthening controls over identifying appropriate supporting documents that are readily available for review and submission; providing training to those responsible for originating the documents to confirm adequacy; and building electronic document repositories to facilitate easy access and retrieval. USMC is also implementing oversight controls to confirm compliance with established controls. Corrective actions are estimated to be completed by 4th quarter 2018.
<b>6. Inadequate A-123 internal control program</b>	The material weakness identified that USMC does not have a robust OMB Circular A-123 internal control program. The Marine Corps MICP implementation was deemed ineffective and insufficiently resourced.	USMC is still in the early stages of implementing a comprehensive ERM capability to meet the OMB Circular A-123 internal control program and the GAO's <i>Standards for Internal Control in the Federal Government</i> requirements. Corrective actions completion timeframe is in process of being established.



## FFMIA COMPLIANCE ASSESSMENT

The FFMIA of 1996 requires agencies to implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards promulgated by the Federal Accounting Standards Advisory Board, and the U.S. Standard General Ledger (USSGL) at the transaction level. Financial management systems include both financial and financially related (or mixed) systems. FFMIA supports the same objectives as the Chief Financial Officers Act of 1990 but with a systems emphasis. The USMC and DFAS are jointly responsible for implementing and maintaining financial management, accounting and reporting systems that substantially comply with Federal financial management

systems requirements, U.S. GAAP, and the USSGL at the transaction level.

The USMC's financial systems did not fully comply with the Federal financial management system requirements, Federal accounting standards, and application of the USSGL at the transaction level as of September 30, 2017. With respect to the FFMIA non-compliant systems, USMC is in process of determining the nature, extent, and primary reason or cause of the noncompliance to effectively facilitate remediation plans necessary to bring the agency's financial management systems into substantial compliance.

## COMPLIANCE WITH OTHER KEY LEGAL AND REGULATORY REQUIREMENTS

As of September 30, 2017, USMC is in the early stages of developing and implementing a robust program to perform a comprehensive assessment of USMC's compliance with key legal and regulatory

financial requirements. USMC plans to provide the results of its compliance assessment in future Agency Financial Reports.

## SYSTEM STRATEGY, OVERVIEW OF SYSTEM FRAMEWORK, SYNOPSIS OF CRITICAL PROJECTS

The Marine Corps System Strategy consists of internal control test plans for performing Federal Information System Controls Audit Manual (FISCAM) and complementary user entity control reviews of relevant and material USMC-owned financial systems. The reviews assessed the effectiveness of general, application-level, and third-party information technology (IT) controls. The Marine Corps strategy also supports the Risk Management Framework requirements to monitor security controls continuously, determine the security impact of changes to the DoD Information Network and operational environment, and conduct remediation actions as described in DoD Instruction 8510.01. During FY 2017, USMC successfully conducted an internal materiality assessment to identify systems relevant and material to audit. The USMC completed FISCAM reviews for USMC-owned systems and continue to coordinate with information technology system service providers to ensure audit requirements are

met. Approximately 28 systems owned by others relevant to the USMC audit still require assessment.

The system complexities of today includes an aggregate of technology, scale, scope, operational, and organizational issues. The USMC business practices, technologies applied, and the changing operational environment presents several dynamic challenges. The full financial statement audit has exposed vulnerabilities in the operational environment involving interfaces among systems; and various system interactions. Thus, USMC enterprise has a number of projects that are critical to audit success. One major initiative is the implementation of Global Combat Support System (GCSS-MC). The GCSS-MC implementation is ongoing and is modernizing USMC logistics and supply chain management. Current efforts will not only improve accountability over assets but will increase the visibility over the management of OM&S.



Marines stand at the position of attention. (U.S. Marine Corps photo by Cpl. Samantha Braun)

## LIMITATION OF FINANCIAL STATEMENTS

The principal financial statements have been prepared to report the financial position and results of operations of the USMC, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with GAAP for Federal entities (except as otherwise noted in the footnote disclosures) and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.



## **SECTION 2:** Financial Section



# MESSAGE FROM FISCAL DIRECTOR OF THE MARINE CORPS



**DEPARTMENT OF THE NAVY**  
**HEADQUARTERS UNITED STATES MARINE CORPS**  
3000 MARINE CORPS PENTAGON  
WASHINGTON, DC 20350-3000

October 2017



The United States Marines Corps is the nation's crisis response force and force in readiness—forward deployed to rapidly respond to crises throughout the world. Our Marines continue to serve with distinction whether they are conducting advise and assist operations in Afghanistan, combat support operations to defeat Islamic State in Iraq and Syria (ISIS), or training for sustained ground combat ashore as part of a major regional contingency. Ensuring our Marines are properly supported to deliver a full range of warfighting capabilities requires sound resource management and business practices. As the Congress, the Secretary of Defense, the Secretary of the Navy and the Commandant of the Marine Corps demand improved accountability for our stewardship of resources, we continue to seek ways to address our challenges effectively and efficiently, while still supporting the warfighter.

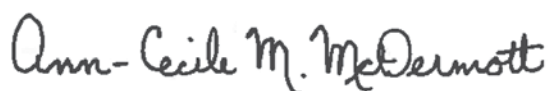
The Marine Corp's FY 2017 Agency Financial Report (AFR) provides detailed financial information that reflects our continued focus on effective stewardship of taxpayer resources as we meet mission requirements and achieve operational excellence. This year, our report provides specifics on the Marine Corps resources that are included in the Department of the Navy FY 2017 AFR. It also addresses how the Marine Corps supports the Secretary of the Navy's strategic goals and objectives. Our FY 2017 AFR also highlights the results of our first Full Financial Statement (FFS) audit. This is another step towards a clean financial statement opinion that began in earnest in 2005 and has continued through the dedicated efforts of many Marines and civilian Marines during the past twelve years. We continue to work to sustain audit improvements and to strengthen internal controls, improve business processes and systems, effectively train our Marines, and improve accounting and financial reporting procedures. Our efforts have not been without challenges, but the dedicated work of many thousands of Marines and civilians are helping us to make incremental progress.

In September 2016, the Marine Corps began its FFS audit. Similar to previous efforts, such as the audits of the Statement of Budgetary Resources and the Schedule of Budgetary Activity, the Marine Corps is aggressively out in front as the lead service to pursue an audit opinion on its full financial statements. We continue to share lessons learned with the Department of the Navy, the other military departments, and the Office of the Secretary of Defense from our preparation and the execution of our FFS audit. In addition to specific findings, key lessons include the basics of strong audit engagement such as establishing standard communication protocols with our auditor and at Headquarters and field locations, the importance of elevating issues quickly, and the risk of underestimating what is required to meet audit standards.

During the course of the FY 2017 FFS, the Marine Corps received many notifications of findings and recommendations (NFRs). In response, we continue to work closely with our auditor to fully understand our shortfalls and to build effective and testable corrective action plans. In addition, we have reorganized our internal control organization to better address entity level internal control deficiencies. In recognition of the NFRs and deficiencies we have, we will be initially measuring ourselves by the reduction of findings from year to year, not on the opinion we receive. I believe that if we continue to do this effectively, we will eventually reduce our discrepancies enough to gain and sustain a clean financial opinion. We also continue to identify and follow-up on Department of Defense (DoD) wide issues that require action from multiple stakeholders from across the Department. These issues include system limitations and controls, transportation of things, inventories and valuations, Material Returns Program, and contract financing payments administered by Mechanization of Contract Administration Services. We will continue to support Defense Finance and Accounting Service, Defense

Logistics Agency, the DoD Inspector General and others as they address these concerns. In conjunction, we intend to sustain improvements already made; and to prioritize, develop and implement aggressive corrective actions to resolve audit findings across the Marine Corps. We further recognize that a successful audit is predicated on a system of internal controls that promotes continuous assessment and improvement in all areas (operational, financial, and information technology systems) impacting the financial statements. This continues to be a great challenge, but we're embracing the opportunity and demonstrating our commitment to improving the business practices of the Marine Corps across the board. As we proceed through the audit journey, we also continue to recognize benefits from having more timely and accurate data to support decision-making across a wide range of subject areas.

As we look forward to assisting the Department of the Navy in achieving a clean opinion in the future, I want to express my thanks to our Marines and civilian Marines, plus our other service members for their dedicated efforts and many long hours spent on achieving this goal and ensuring Marines have what they need.



Ann-Cecile M. McDermott  
Fiscal Director of the Marine Corps



2017

# OFFICE OF INSPECTOR GENERAL TRANSMITTAL



**INSPECTOR GENERAL**  
DEPARTMENT OF DEFENSE  
4800 MARK CENTER DRIVE  
ALEXANDRIA, VIRGINIA 22350-1500

November 9, 2017

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/  
CHIEF FINANCIAL OFFICER, DoD  
COMMANDANT OF THE MARINE CORPS  
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL  
MANAGEMENT AND COMPTROLLER)  
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE  
NAVAL INSPECTOR GENERAL

SUBJECT: Transmittal of the Disclaimer of Opinion on the United States Marine Corps  
General Fund Financial Statements and Related Footnotes for FY 2017  
(Project No. D2016-D000FS-0218.000, Report No. DODIG-2018-024)

We contracted with the independent public accounting firm of Kearney & Company to audit the United States Marine Corps (USMC) FY 2017 Financial Statements and related footnotes as of September 30, 2017, and for the year then ended, and to provide a report on internal control over financial reporting and compliance with laws and regulations. The contract required Kearney & Company to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/President's Council on Integrity and Efficiency, "Financial Audit Manual," July 2008. Kearney & Company's Independent Auditor's Reports are attached.

Kearney & Company's audit resulted in a disclaimer of opinion. Kearney & Company could not obtain sufficient, competent evidence to support the reported amount within USMC financial statements. As a result, Kearney & Company could not conclude whether the financial statements and related footnotes were fairly presented in accordance with accounting principles generally accepted in the United States of America. Accordingly, Kearney & Company did not express an opinion on the USMC FY 2017 Financial Statements and related footnotes.



Kearney & Company's separate report on "Internal Control over Financial Reporting" discusses nine material weaknesses related to USMC's internal controls over financial reporting. Kearney & Company's additional report on "Compliance with Applicable Laws, Regulations, Contracts, and Grant Agreements" discusses three instances of noncompliance with applicable laws and regulations.

In connection with the contract, we reviewed Kearney & Company's report and related documentation and discussed the audit results with Kearney & Company representatives. Our review, as differentiated from an audit in accordance with GAGAS, was not intended to enable us to express, and we did not express, an opinion on the USMC FY 2017 Financial Statements and related footnotes, conclusions about the effectiveness of internal control, conclusions on whether the USMC's financial systems substantially complied with the "Federal Financial Management Improvement Act of 1996," or conclusions on whether the USMC complied with laws and regulations.

Kearney & Company is responsible for the attached reports, dated November 9, 2017, and the conclusions expressed in these report. However, our review disclosed no instances in which Kearney & Company did not comply, in all material respects, with GAGAS.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601 5945.

Lorin T. Venable, CPA  
Assistant Inspector General  
Financial Management and Reporting

# INDEPENDENT AUDITOR'S REPORT



1701 Duke Street, Suite 500, Alexandria, VA 22314  
PH: 703.931.5600, FX: 703.931.3655, www. Kearneyco.com

## INDEPENDENT AUDITOR'S REPORT

To the Commandant of the United States Marine Corps and Inspector General of the Department of Defense

### Report on the Financial Statements

We were engaged to audit the accompanying consolidated financial statements of the United States Marine Corps (Marine Corps), which comprise the consolidated balance sheet as of September 30, 2017, the related consolidated statements of net cost and changes in net position, and the combined statement of budgetary resources (hereinafter referred to as the "financial statements") for the year then ended, and the related notes to the consolidated financial statements.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted the audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*. Because of the matters described in the Basis for Disclaimer of Opinion section below, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### Basis for Disclaimer of Opinion

We were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion that the financial statements are free from material misstatements when taken as a whole. The Marine Corps disclosed in Note 1, *Significant Accounting Policies*, instances where its current accounting and business practices represent departures from accounting principles generally accepted in the United States of America. As a result, the Marine Corps was unable to assert that the financial statements are presented fairly in accordance with accounting principles generally accepted in the United States of America. The Marine Corps asserted to the following departures from accounting principles generally accepted in the United States of America:

- Accrual accounting requirements per Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*, and SFFAS No. 5, *Accounting for Liabilities of The Federal Government*
- Recognition and valuation requirements set forth in SFFAS No. 3, *Accounting for Inventory and Related Property*
- The full cost provisions of SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, as amended by SFFAS No. 30, *Inter-Entity Cost Implementation*, and the reporting requirements associated with presenting the Statement of Net Cost by major program
- Contingent legal liability requirements set forth in SFFAS No. 5 and SFFAS No. 12, *Recognition of Contingent Liabilities Arising from Litigation*
- Recognition and valuation requirements set forth in SFFAS No. 6, *Accounting for Property, Plant, and Equipment*
- Revenue recognition requirements set forth in SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*
- Accounting and reporting requirements associated with restatements per SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, and Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements* (OMB Circular A-136)
- Reporting and valuation requirements set forth in SFFAS No. 29, *Heritage Assets and Stewardship Land*, and disclosure requirements in SFFAS No. 42, *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards No. 6, No. 14, No. 29, and No. 32*.

Additionally, the Marine Corps was not able to produce financial statements and disclosures in accordance with OMB Circular A-136.

We were unable to obtain sufficient appropriate evidential matter as to the completeness of the reporting entity. As disclosed in Note 1, the Marine Corps has not reported the transactions and balances as of and for the period ended September 30, 2017 for the Medicare-Eligible Retiree Health Care Fund (MERHCF) Contributions for Marines and Marine Corps Reserves personnel. Additionally, we were unable to obtain sufficient appropriate evidential matter as to the completeness of the Fund Balance with Treasury (FBWT), environmental liabilities, and contingent legal liabilities balances on the balance sheet as of September 30, 2017. As of September 30, 2017, the Marine Corps reported \$9.4 billion of FBWT, \$212.1 million of environmental liabilities, and \$16 million of contingent legal liabilities on its balance sheet.

Given the nature and decentralized location of the agency's operating materials and supplies (OM&S), the Marine Corps does not perform physical inventory procedures as of the balance sheet date. For some OM&S non-ammunition asset classes, a physical inventory control program is not in place. The Marine Corps' inventory control programs in place are designed to achieve annual inventory requirements through a series of recurring inventory procedures performed over a 12-month period, across OM&S custodian locations. We were unable to obtain the OM&S transactional data necessary to reconcile OM&S quantities observed as of a point in





time to opening balances and ending balances for the fiscal year (FY). The Marine Corps was unable to provide OM&S data for certain asset classes to allow audit procedures to be conducted, or the OM&S data available from Marine Corps systems did not provide sufficient information by which to test for the existence, completeness, and valuation of the reported balances. As of September 30, 2017, the Marine Corps reported \$11.0 billion of net OM&S within the Inventory and Related Property line item of the balance sheet.

We were unable to obtain sufficient appropriate evidential matter to enable us to perform audit procedures to satisfy ourselves that the Property, Plant, and Equipment (PP&E) opening balances as of October 1, 2016 were free of material misstatements. Our work identified issues related to existence, completeness, valuation, and accuracy of real property and general equipment. As of September 30, 2017, the Marine Corps reported \$16.8 billion in net PP&E on its balance sheet.

We were unable to obtain sufficient appropriate evidential matter to support the existence and accuracy of Unpaid obligations, brought forward, Oct 1 and the occurrence and accuracy of Recoveries of unpaid prior-year obligations. As of September 30, 2017, the Marine Corps reported \$7.3 billion of Unpaid obligations, brought forward, Oct 1 and \$800.1 million of Recoveries of unpaid prior-year obligations on its Statement of Budgetary Resources. In addition, we were unable to obtain sufficient appropriate evidential matter to support the occurrence and accuracy of expenses, specifically those arising from transactions other than payroll. The Marine Corps' non-payroll expenses are reported as part of the Gross Costs balance within the Statement of Net Cost for the period ended September 30, 2017.

As disclosed in Note 1, the Marine Corps' consolidated financial statements for FY 2017 include amounts related to opening balance adjustments, which have been recorded as current-year activity. Such adjustments, totaling \$1.2 billion, were not applied properly in accordance with SFFAS No. 21.

The effects of the conditions described in the preceding seven paragraphs cannot be fully quantified, nor was it practical, given the available information, to extend audit procedures to sufficiently determine the extent of the misstatements to the financial statements. The effects of the conditions in the preceding seven paragraphs and overall challenges in obtaining timely and sufficient audit evidence also made it impractical to execute all planned audit procedures. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary for the elements making up the Marine Corps' financial statements.

### **Disclaimer of Opinion**

Because of the significance of the matters described in the Basis for Disclaimer of Opinion section above, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these consolidated financial statements.



### **Emphasis of Matter**

As discussed in Note 1 to the financial statements, the Marine Corps' financial statements and disclosures do not include working capital fund (WCF) balances as of September 30, 2017 and activities for the year then ended. We were not engaged to audit the WCF of the Marine Corps; therefore, our opinion is not modified with respect to this matter.

As discussed in Note 1 to the financial statements, the Marine Corps' financial statements and disclosures are inclusive of Marine Corps balances as of September 30, 2017 and activities for the year then ended from funds that are shared with the Department of the Navy (DON). We were engaged to audit the portion of these funds allotted to the Marine Corps. We were not engaged to audit the DON's portion of the shared funds. Our opinion is not modified with respect to this matter.

### **Other Matters**

#### ***FY 2016 Financial Statements Not Audited***

The Marine Corps' consolidated financial statements for FY 2016, as of and for the year ended September 30, 2016, were not audited, reviewed, or compiled by us; accordingly, we do not express an opinion or any other form of assurance on them.

#### ***Implementation of Statement of Federal Financial Accounting Standards for Establishing Opening Balances***

The Marine Corps began implementation of SFFAS No. 50, *Establishing Opening Balances for General Property, Plant, and Equipment*, and SFFAS No. 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*, for its FY 2017 opening balances. Effective for periods beginning after September 30, 2016, the Federal Accounting Standards Advisory Board (FASAB) released SFFAS No. 50 and SFFAS No. 48, which allow a reporting entity, under specific conditions, to apply alternative methods in establishing opening balances. We planned and performed our audit procedures over PP&E and OM&S opening balances accordingly. As of September 30, 2017, the Marine Corps' implementation of SFFAS No. 50 and SFFAS No. 48 remains in process.

#### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis, Required Supplementary Information, and Required Supplementary Stewardship Information (hereinafter referred to as the "required supplementary information") be presented to supplement the consolidated financial statements. Such information, although not a part of the consolidated financial statements, is required by OMB and FASAB, who consider it to be an essential part of the financial reporting for placing the consolidated financial statements in an appropriate operational, economic, or historical context. We were unable to apply certain limited procedures to the required supplementary information in



accordance with auditing standards generally accepted in the United States of America because of matters described in the Basis for Disclaimer of Opinion section above. We do not express an opinion or provide any assurance on the information.

### ***Other Information***

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. Other Information, as named in the Agency Financial Report, is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the consolidated financial statements; accordingly, we do not express an opinion or provide any assurance on it.

### ***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards* and OMB Bulletin No. 17-03, we have also issued reports, dated November 9, 2017, on our consideration of the Marine Corps' internal control over financial reporting and on our tests of the Marine Corps' compliance with provisions of applicable laws, regulations, contracts, and grant agreements, as well as other matters for the year ended September 30, 2017. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance and other matters. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 17-03 and should be considered in assessing the results of our audit.

A handwritten signature in blue ink that reads "Kearney &amp; Company".

Alexandria, Virginia  
November 9, 2017



## INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Commandant of the United States Marine Corps and Inspector General of the Department of Defense

We were engaged to audit, in accordance with the auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*, the consolidated financial statements of the United States Marine Corps (Marine Corps) as of and for the year ended September 30, 2017, and we have issued our report thereon dated November 9, 2017. Our report disclaims an opinion on such financial statements because we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. The Marine Corps also asserted to departures from generally accepted accounting principles.

### Internal Control over Financial Reporting

In connection with our engagement to audit the consolidated financial statements, we considered the Marine Corps' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Marine Corps' internal control. Accordingly, we do not express an opinion on the effectiveness of the Marine Corps' internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 17-03. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies; therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings to be material weaknesses.



A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance. We noted certain additional matters involving internal control over financial reporting that we will report to the Marine Corps' management in a separate letter.

### **Marine Corps' Response to Findings**

The Marine Corps' response to the findings identified in our engagement is described in a separate memorandum attached to this report in Section 2, *Financial Section*, of the Agency Financial Report. The Marine Corps' response was not subjected to the auditing procedures applied in our engagement of the consolidated financial statements; accordingly, we do not express an opinion on it.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and the results of that testing, and not to provide an opinion on the effectiveness of the Marine Corps' internal control. This report is an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* and OMB Bulletin No. 17-03 in considering the entity's internal control. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in blue ink that reads "Kearney &amp; Company". The signature is stylized and cursive.

Alexandria, Virginia  
November 9, 2017

## Schedule of Findings

### Material Weaknesses

#### I. Entity-Level Controls (New Condition)

**Background:** Entity-level internal controls relate to an entity's control environment, risk assessment processes, information and communication, and monitoring of control effectiveness over time. They are enterprise-wide and have a pervasive effect on an entity's internal control system. The Federal Managers' Financial Integrity Act of 1982 (FMFIA) requires each Executive agency to establish and implement controls in accordance with standards prescribed by the Comptroller General of the United States, as codified in the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* (the Green Book).

Agencies respond to these requirements by implementing Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*. In addition, components within the Department of Defense (DoD) use the Managers' Internal Control Program (MICP) to support their responses to these requirements.

**Condition:** The Marine Corps has not fully implemented processes to evaluate its entity-level internal controls. Specifically, it did not document and assess its control environment, financial reporting objectives, financial reporting risk assessments, centrally designed internal control activities, internal control directives, and monitoring procedures to ensure internal controls remain effective over time.

The Marine Corps has not finalized process cycle narratives designed to assist agency management with the identification and evaluation of internal controls over financial reporting. The process cycle narratives provided during our audit were marked as draft, did not properly distinguish internal control activities from process steps or informational statements, and, in the case of financial reporting controls, addressed only the Schedule of Budgetary Activity, not the general purpose financial statements.

With regard to the information technology (IT) environment, the Marine Corps is in the process of implementing a Risk Management Framework (RMF) for its information system environment on a system-by-system basis. The Marine Corps has not fully implemented comprehensive risk management for the IT control environment. This includes an incomplete multi-tier risk management approach to consider risks at the organization, business process, and information system levels. The Marine Corps assesses risk on a system-by-system basis, but it does not assess system risk for the IT control environment at the organization and business process levels, including consideration of non-Marine Corps systems that may affect financial reporting and operations.





The Marine Corps does not maintain complete documentation of appropriate points of contact (POC), locations of system program management offices, parties responsible for administering and operating systems, and locations of the hosting facilities and enclaves for many of the Marine Corps and third-party systems. Additionally, the Marine Corps does not maintain documentation of the personnel responsible for monitoring third parties that affect financial reporting and related business processes.

The Marine Corps does not have a process in place to monitor the military pay and personnel system, Marine Corps Total Force System (MCTFS), service provider controls and deviations within the Service Organization Controls (SOC) 1 report. The service-level agreement (SLA) between Marine Corps and its service provider does not define the procedures for the backup of critical system files, activation of a Continuity of Operations Plan, or notification to relevant stakeholders.

**Cause:** While the Marine Corps maintains a MICP, the Program does not adequately address internal control over financial reporting or consider all FMFIA and Green Book requirements in the design and implementation of entity-level controls, including those controls necessary in the information system environment. The Marine Corps has not completely documented its entity-level controls to demonstrate that the controls achieve all control objectives and are operating together in an integrated manner. In addition, the Marine Corps has not fully implemented comprehensive risk management for the IT control environment at the organization level, including consideration of non-Marine Corps systems and documentation of all the sources and stakeholders for its systems that may affect financial reporting and operations. Minimal resources in place to address the overall system risk for the entire Marine Corps IT control environment prevented completion of an overall system risk assessment. Furthermore, the Marine Corps has not documented a process to monitor SOC 1 report controls or the deviations noted in the SOC 1 reports.

**Effect:** Absent entity-level controls and comprehensive understanding of the IT environment, the Marine Corps faces an increased risk of not identifying and properly responding to relevant financial reporting risks, including information system risks and threats, in an effective manner (e.g., failing to develop the controls necessary to mitigate those risks). Incomplete internal control documentation impedes the Marine Corps' ability to monitor the design, implementation, and operating effectiveness of its entity-level controls over time. Insufficient entity-level controls affect the Marine Corps' entire system of internal control because transactional controls depend on entity-level controls' effective design and implementation. Without ongoing monitoring of third-party service providers, performance and control issues may go unnoticed, affecting the design and operating effectiveness of the Marine Corps' control environment, and all material weaknesses in internal control may not be identified by management.

**Recommendations:** Kearney & Company, P.C. (Kearney) recommends that the Marine Corps:

1. Perform a gap analysis of the current system of internal control to the Green Book to identify principles and/or attributes that are missing or require improvement. The Marine

- Corps should utilize the guidance within OMB Circular A-123 to implement effective entity-level controls that are relevant to the preparation of its financial statements.
2. Develop and document a formalized process to identify and document financial reporting objectives and any corresponding financial reporting risks. This process should serve as the foundation for the Marine Corps' subsequent risk responses (i.e., avoidance, acceptance, sharing), including the design, implementation, and maintenance of internal controls over financial reporting.
  3. Document and implement a program that includes an entity-wide control assessment of the financial reporting environment, including systems, that is compliant with OMB Circular A-123 requirements.
  4. Develop and routinely maintain documentation of entity-level controls to demonstrate that controls are operating in an integrated manner and that all principles and attributes of internal control have been adequately designed and effectively implemented.
  5. Establish a mechanism to provide for adequate review of process cycle narratives to finalize them, in addition to helping ensure stakeholders document business processes completely and identify internal control activities accurately.
  6. Provide stakeholders with training to enable them to properly identify internal control activities and differentiate them from process steps and informational statements.
  7. Develop a comprehensive guide of all Marine Corps and third-party systems that affect the financial statements, to include:
    - a. System POCs, including those responsible for monitoring third-party systems
    - b. Locations of system program management offices
    - c. Parties responsible for administering and operating the system
    - d. Locations of the hosting facilities and enclaves for the system.Review and update the comprehensive guide on a periodic basis (at least annually).
  8. Continue to transition all of the Marine Corps' systems to the RMF propagated by the National Institute of Standards and Technology (NIST).
  9. Assess the risk at the organization and mission/business process tiers, in addition to the current assessments at the information system tier, in accordance with NIST Special Publication (SP) 800-30, *Guide for Conducting Risk Assessments*, including consideration of service providers/external entities.
  10. Implement security controls to address the risks using the risk assessments and the Marine Corps' risk tolerance.
  11. Work with the service provider to add relevant content to the MCTFS SLA for contingency planning, as well as the associated roles and responsibilities.
  12. Develop and implement policies and procedures for the monitoring of third-party service provider controls in accordance with NIST SPs 800-53, *Security and Privacy Controls for Federal Information Systems and Organizations*, and 800-35, *Guide to Information Technology Security Services*, including routine meetings and follow-up for any control deviations noted in SOC 1 reports.

## II. Ability to Provide Complete, Timely, and Sufficient Evidence (New Condition)

Deficiencies in three related areas define this material weakness:

- A. Timeliness of business process documentation for financial management and IT business processes, including policies and procedures and other related documents
- B. Transaction-level data populations supporting account balances and activities reported on its financial statements and disclosures
- C. Complete and timely support for sampled transactions and follow-up requests made during the course of our audit.

**Background:** Documentation (i.e., evidential matter) takes many forms, including policies and procedures, results from self-assessments, and support for transactions and business events that allow for the examination by management and internal or external parties, including auditors. It is critical for entities to maintain documentation to support accounting transactions and the design and operating effectiveness of internal control over operations, reporting, and compliance.

### A. Timeliness of Business Process Documentation

**Condition:** Based on the analysis of requests made as of September 29, 2017, the Marine Corps provided documentation or other information or data after the established due date more than 50% of the time.

**Cause:** The Marine Corps' business processes, associated internal controls, and dependencies on legacy information systems and service providers contributed to its inability to timely and sufficiently evidence controls and recorded transactions. A decentralized environment and insufficient document retention tools integrated into the business processes compounded the issue.

In addition, the Marine Corps did not consistently make IT documentation requests of the correct stakeholders due to incomplete documentation of appropriate POCs, locations of system program management offices, parties responsible for administering and operating systems, and locations of the hosting facilities and enclaves for many of the Marine Corps and/or third-party systems. Some systems did not have the capability to readily generate lists of system changes that tie back to change management tools.

**Effect:** Without readily available documentation or evidence, the Marine Corps' management may not be able to perform assessments to monitor the design and operating effectiveness of controls, nor assure itself of the material accuracy of its reported balances and activities.



**Recommendations:** In addition to Recommendation #7 in Section I, *Entity-Level Controls*, Kearney recommends that the Marine Corps:

1. Assess entity-wide internal controls over the financial reporting environment, including systems, to ensure compliance with OMB Circular A-123 requirements.
2. Develop and implement a repository of documentation (e.g., reconciliations and user access listings) to ease the retrieval and response process.

#### **B. Transaction-Level Data Populations Supporting Account Balances**

**Condition:** Data populations were not available, not available timely, or incomplete for multiple transaction classes, to include:

- Accounts Receivable (AR), Accounts Payable (AP), and Obligations Incurred – The Marine Corps was unable to produce open AR and AP balances reports by customer or vendor, respectively. Further, the Marine Corps was unable to produce reports for new obligations incurred and upward adjustments for a specified period of time. In addition, the Marine Corps' AP related to cancelled appropriations are not available at the transaction level or reviewed to confirm validity
- Operating Materials and Supplies (OM&S) – The Marine Corps was unable to provide sufficient OM&S transactional data for 91% of its OM&S opening balances to allow testing over the existence, completeness, and valuation of the reported balances. See further detail in Section VI, *Accounting for Operating Materials and Supplies*
- Other Environmental Liabilities (OEL) – The Marine Corps did not include a complete population of OEL estimates in the opening balance for fiscal year (FY) 2017. Estimates for OEL related to general equipment, including military equipment, were not calculated for the opening balance, were reported by other DoD components, and were not reported by the Marine Corps
- Unfunded Accrued Leave Liability – Civilian payroll unfunded accrued leave liability was not available at the employee level for approximately \$117 million recorded as the opening balance
- System Changes – The Marine Corps provided incomplete system change populations for Standard Accounting, Budget, and Reporting System (SABRS) and MCTFS testing. The Marine Corps did not provide SABRS Management Analysis Retrieval System (SMARTS) or General Combat Support System (GCSS) system change populations in time to complete testing of operating effectiveness. In addition, the Marine Corps did not provide a system-generated list of changes for the Marine Corps Orders Resource System (MCORS).

**Cause:** In addition to the causes described in Part A, the service provider only maintained detailed employee-level unfunded accrued leave liability reports for a limited time.

**Effect:** The effect is presented in Part A above.

**Recommendations:** Kearney recommends that the Marine Corps:

1. Develop periodic compilation and review of open AR, AP, and new obligations incurred and upward adjustments reports. Update the accounting system of record and feeder systems to capture standardized data input for AR, AP, and new obligations incurred and upward adjustments activity to ensure consistency and completeness of data elements recorded.
2. Work with system owners and service providers, as appropriate, to make available transaction-level detail for cancelled appropriations' AP to support reporting and monitoring requirements after the close of the FY.
3. Continue ongoing efforts to transition to OM&S Ammunition and Non-Ammunition accountable property systems of record (APSR) that have the capability of providing transaction-level details, ensuring all required and critical data fields are accommodated by the system transitions.
4. Establish guidelines and methodology for an assessment of all Marine Corps asset classes to determine if OEL cost estimates should be developed and reported by the Marine Corps.
5. Work with system owners and service providers, as appropriate, to make available employee-level detail for civilian payroll unfunded leave liability to support reporting and monitoring requirements.

### **C. Complete and Timely Documentation Supporting Sampled Transactions**

**Condition:** The Marine Corps' responses to requests for documentation supporting selected transactions were either incomplete, untimely, or not clearly associated with the transaction amounts or pertinent data elements. For sampled transactions, Kearney was unable to conclude on more than 25% of sample items received due to supporting documentation that was insufficient or not provided. These conditions occurred across various areas, including:

- Unpaid Obligations Brought Forward, Recoveries of Unpaid Prior-Year Obligations, and New Obligations Incurred and Upward Adjustments
- Opening Balances for Property, Plant, and Equipment (PP&E)
- Fund Balance with Treasury (FBWT)
- Outlays and Collections
- Non-Payroll Expenses and AP
- Military Payroll
- Revenue and AR
- IT Internal Control Testing.

**Cause:** The cause is presented in Part A above.

**Effect:** The effect is presented in Part A above.



**Recommendation:** Kearney provides the following recommendations for the Marine Corps' consideration:

1. Provide training to personnel regarding documentation retention requirements.
2. Disseminate the PP&E opening balance audit testing results to Program Managers and custodians to promote awareness of the impact that untimely, insufficient supporting documentation and ineffective inventory management controls can have on property valuation and accountability.
3. Update journal voucher (JV) preparation procedures to include retention of transaction-level support for all JVs, including the cumulative records to support the balances in accordance with record retention requirements.
4. Create or leverage existing centralized document retention systems to achieve centralized storage for maintaining military payroll documentation.
5. Implement a monitoring mechanism to ensure IT documentation is reviewed at least annually and updated when significant process changes occur throughout the year.

### **III. Financial Reporting and Analysis (New Condition)**

Deficiencies in three related areas define this material weakness:

- A. Completeness of the Marine Corps' financial statements and disclosures
- B. Financial management and oversight
- C. Accounting for estimates.

**Background:** Financial reporting is the process by which an entity accumulates and discloses information on its financial position and performance, as maintained in its books and records, through financial statements and related disclosures. OMB Circular A-136, *Financial Reporting Requirements*, provides Federal entities guidance on the form and content of Federal financial statements and disclosures.

Entities record business events affecting financial reports in a general ledger (GL) or subsidiary ledger in accordance with generally accepted accounting principles (GAAP), as prescribed by the Federal Accounting Standards Advisory Board (FASAB) and prevailing laws and regulations. These include those established by the Department of the Treasury (Treasury) in the Treasury Financial Manual (TFM), including the United States Standard General Ledger (USSGL). An entity may record estimates to measure amounts and/or accounts where the outcome of future events is pending and uncertain or where the entity cannot accumulate relevant data concerning past events on a timely, cost-effective basis.

As part of the financial reporting process, entities perform financial analysis, reconciliations, and other quality assurance procedures to evaluate the validity and accuracy of financial information, which aids in meeting stewardship responsibilities by identifying risks, errors, and anomalies for research and correction, where applicable.

The Marine Corps operates in a nonintegrated systems environment with financial information from many systems feeding into SABRS, discussed further in Section IV, *Integrated Financial Management Systems*. Marine Corps Commands' financial data are captured within SABRS from several feeders systems (e.g., MCTFS for military pay transactions). Monthly, the Marine Corps' third-party service provider transfers feeder files, including the SABRS Defense Cash Accountability System (DCAS) data file, from SABRS to the Defense Departmental Reporting System (DDRS) – Budgetary (B). The transmitted data from SABRS undergo a series of translations (e.g., pre-processing) and transfers (i.e., from DDRS-B to DDRS – Audited Financial Statements [AFS]) and are updated by a variety of supported and unsupported financial statement adjustments to produce the Marine Corps' financial statements.

The responsibility for preparing, reviewing, approving, and/or monitoring financial activities and transactions to ensure that business events are reflected properly in the financial statements resides with the Marine Corps. Responsibilities include oversight of third-party service providers.

#### **A. Completeness of the Marine Corps' Financial Statements and Disclosures**

**Condition:** The Marine Corps did not adequately define the Marine Corps' reporting entity for which financial statements are prepared. The Marine Corps excluded opening balances and current-year appropriations and activities for several Treasury Account Symbols (TAS) from the financial statements, including the funds provided for contributions to the Medicare-Eligible Retiree Health Care Fund (MERHCF) on behalf of Marines and Marine Reserve personnel.

Additionally, the Marine Corps did not produce an Agency Financial Report (AFR) compliant with GAAP and OMB Circular A-136. For example:

- The Marine Corps did not develop and implement internal control activities to ensure the recognition and disclosure of full costs, including imputed costs, in the financial statements and disclosures. This includes an absence of internal control activities to recognize full costs in cases in which Marine Corps operations are funded by other reporting entities
- The Marine Corps did not record aviation assets or the cost of using aviation assets in the financial statements. Aviation assets for which the Marine Corps meets the FASAB requirements for ownership and recognition, as defined within Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*, and Statement of Federal Financial Accounting Concepts (SFFAC) No. 5, *Definitions of Elements and Basic Recognition Criteria for Accrual Basis Financial Statements*, have been excluded from the Marine Corps' financial statements. Under an alternative interpretation of GAAP in which aviation assets are the financial reporting responsibility of the U.S. Navy, including the aviation assets utilized and maintained by the Marine Corps, the agency did not adhere to the accounting and reporting requirements for recognizing imputed costs as required by SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, in preparing its financial statements



- The AFR did not contain more than five required disclosures or presented partial disclosures in accordance with reporting requirements. For example, the AFR does not disclose the Reconciliation of the Statement of Budgetary Resources to the Budget of the United States and the Statement of Net Cost is not fully compliant with the Government Performance and Results Act of 1993 (GPRA) requirements for reporting costs by major program. Additionally, the deferred maintenance cost estimates for PP&E were not tracked and monitored.

**Cause:** The Marine Corps has not implemented internal controls necessary to produce complete and accurate financial statements and disclosures in compliance with GAAP, as promulgated by FASAB, and OMB Circular A-136. The Marine Corps did not perform a comprehensive analysis of the risks related to financial reporting and did not develop internal controls to mitigate those risks. Additionally, the Marine Corps:

- Has not comprehensively analyzed its operations with respect to the full costing and other requirements in GAAP and, to the extent necessary, identified the internal control activities needed to recognize and disclose full costs, including imputed costs
- Did not sufficiently consider asset recognition requirements under SFFAS No. 6 and SFFAC No. 5 as to which financial reporting component should present aviation assets used by the Marine Corps. Additionally, under the elected accounting treatment to report all Department of the Navy (DON) aviation assets solely as U.S. Navy assets, the Marine Corps did not consider the impact of such accounting treatment when preparing stand-alone financial statements. The Marine Corps did not conduct a full analysis of these activities to determine instances in which imputed costs may be necessary for compliance with SFFAS No. 4
- Has not routinely revisited the development of the financial reporting entity, and, in some instances, financial reporting requirements were not applied correctly
- Has not assessed the Marine Corps' compliance with disclosure requirements using available tools (e.g., GAO Financial Audit Manual [FAM] 2020, *Checklist for Federal Reporting and Disclosures* [FAM 2020]) and did not leverage assessment tools used by other Federal entities.

**Effect:** Ineffectively designed, implemented, and/or operating controls increases the risks of material misstatement and noncompliance with financial reporting requirements. The absence of a formal AFR compliance review process resulted in an inaccurate and incomplete AFR. The Marine Corps was not able to sufficiently articulate compliance issues with OMB Circular A-136 guidance and GAAP in a timely manner. Overall, the Marine Corps' incomplete internal control and review documentation hinders its ability to comply with FMFIA and other relevant laws and regulations and produce accurate financial statements.

Specifically, the AFR, including financial statements and related disclosures, does not meet the minimum presentation and disclosure requirements established in GAAP and OMB Circular A-136 and is incomplete and misstated; however, the full amount of the misstatement could not be determined. Areas where misstatements were noted include:

- TASs funded for approximately \$837 million during FY 2017 were excluded from the financial statements, and the intervening business events and resulting accounting transactions are unknown. Further, the Marine Corps' opening balances may be misstated because the two TASs were funded in excess of \$4.7 billion in the prior years; however, intervening transaction information is unknown
- Amounts related to the implementation of full costs. The absence of a comprehensive analysis of the Marine Corps' operations and full costing requirements in GAAP renders the Marine Corps unable to ensure the completeness and fair presentation of its Statement of Net Cost and Statement of Changes in Net Position in accordance with GAAP
- General PP&E, as presented on the Balance Sheet, is understated by the portion of DON aviation assets which are utilized by the Marine Corps and for which the agency funds regular maintenance and sustainment. Kearney cannot quantify the potential understatement to PP&E, which may be material to the Marine Corps' financial statements
- Additionally, under its currently elected accounting treatment for aviation assets, the Marine Corps has not complied with SFFAS No. 4 to reflect full costs of outputs in its general purpose financial statements. Gross Costs, as presented on the Statement of Net Cost, are understated by the costs associated with the Marine Corps' receipt and use of aviation assets from the DON. The understatement, which may be material, cannot be quantified, as the Marine Corps has not conducted an assessment to determine an appropriate cost estimate.

**Recommendations:** Kearney recommends that the Marine Corps:

1. Develop, implement, and document the processes and controls for the accumulation and review of data prior to the development of the AFR, to include documenting support for disclosures and other analytical information reported in the AFR and a formal AFR compliance review. Use available tools, such as GAO FAM 2010, *Checklist for Federal Accounting*, and FAM 2020, to support the financial reporting process.
2. Establish a formal process to regularly review and evaluate its reporting entity for completeness and compliance with FASAB standards and OMB Circular A-136 reporting requirements. This process should include the review of Office of the Under Secretary of Defense (Comptroller) (OUSD[C]) and DON guidance related to the definition of the Marine Corps' reporting entity. The Marine Corps should maintain documentation to evidence the completion of the review, including the analysis performed, the sources referenced, and the conclusions reached.
3. Work with OUSD(C) and the DON to update policies or requirements to allow for GAAP and OMB Circular A-136 reporting, as needed. The Marine Corps should validate the implementation of any changes to the reporting entity and the resulting financial

- statements and disclosures, including the effects on opening balances and disclosures as a result of recording prior period adjustments.
4. Maintain documentation of internal controls surrounding the financial reporting process and make it readily available to management, the auditor, and other stakeholders, as applicable.
  5. Conduct a comprehensive analysis of non-reimbursed and under-reimbursed Marine Corps operations paid for by other entities to determine compliance with the full costing requirements in GAAP and the Federal Financial Management Improvement Act of 1996 (FFMIA). Based on the analysis, develop and implement a Marine Corps policy, including the development and implementation of internal control activities, to help ensure proper, auditable recognition and disclosure of full costs, including imputed costs for the non-reimbursed and under-reimbursed portion of the costs of goods and services received from other entities. The policy should specify the frequency with which full costing analyses should be performed to capture new sources of imputed costs and imputed financing that arise as operations change.
  6. Provide training to personnel to help ensure imputed costs are properly recognized and disclosed.
  7. Revise, in consultation with the DON, Marine Corps accounting policy and procedures for the treatment of aviation assets and verify all policy is in accordance with GAAP. To comply with current accounting standards, the Marine Corps should:
    - a. Review all significant asset classes (i.e., real property, military equipment, and garrison property) operated by the Marine Corps and presented on the financial statements and note disclosures of other entities (e.g., U.S. Navy). Work with the U.S. Navy and any other entities to determine which component(s)/entity(ies) meet the FASAB requirements for ownership and recognition.
    - b. Present on the financial statements the appropriate portion of DON aviation assets used by the Marine Corps and for which the agency funds regular maintenance and sustainment expenses.
    - c. Under the currently elected accounting treatment for aviation assets, develop an estimation model to reflect the full cost of outputs in its general purpose financial statements to meet the requirements set forth in SFFAS No. 4, resulting in an accounting treatment for aviation assets that is in accordance with GAAP.
  8. Disclose in financial statement notes the relationship with the DON as it pertains to aviation assets, including the volume and value of aviation assets used in the Marine Corps' business operations.

## **B. Financial Management Analysis and Oversight**

**Condition:** The Marine Corps' financial management analysis and oversight deficiencies pertain to its understanding of GAAP, the GL system's USSGL compliance, financial management analysis, service provider control activities and oversight, and the data provided to support financial reporting activities.

The Marine Corps has not completed a comprehensive analysis of its compliance with or departures from GAAP. Upon initial inquiry, management noted that it did not consider itself to have any non-GAAP policies, procedures, or practices. However, audit tests led to the identification of several accounting and reporting practices that represent departures from GAAP. Examples of areas for which there are departures from GAAP include full costs and imputed cost treatment, accounting for physical assets, and reporting entity definition, as discussed in Section III.A, *Completeness of the Marine Corps' Financial Statements and Disclosures*, above. Additionally, the Marine Corps inconsistently presented Funds from Dedicated Collections on the Balance Sheet and the Statement of Changes in Net Position.

The Marine Corps' GL system, SABRS, as currently implemented, is not fully compliant with USSGL. Specifically, SABRS does not:

- Accumulate or transmit complete and accurate attribute data to support financial reporting requirements
- Currently accomplish year-end closing of period accounts and the SABRS tables developed to support SABRS closing are not fully used, nor routinely reviewed for USSGL compliance
- Possess General Ledger Account Numbers (GLAN) that match standard USSGL accounts correctly, in all instances, and require a crosswalk for reporting
- Contain, in all instances, debit and credit combinations that adhere to USSGL-prescribed posting logic
- Properly record trading partner information as evidenced by DDRS reclassification JVs. Although the trading partner indicator and trading partner main account attributes reside in SABRS, they are either not complete or not used to support intragovernmental reconciliations.

The Marine Corps has not designed sufficient financial management analysis over SABRS and DDRS data and balances in support of internal controls over financial reporting. For example:

- Monthly procedures are limited to budgetary analytical analysis and do not sufficiently include proprietary monitoring or validation of proprietary to budgetary relationships
- Abnormal balance conditions within SABRS at the TAS trial balance and account levels are not monitored
- Fluctuation analysis criteria for identifying line items for analysis are limited to specific line items and notes, resulting in significant unexplained fluctuations
- Where fluctuation analysis was performed, the documented results of the analysis typically identified the source of the variance; however, sufficient analysis to understand the underlying root causes of the variances was not completed and/or not documented
- The fluctuation analysis is not performed at the TAS trial balance and account levels.

A third-party service provider performs financial reporting and GL maintenance support services for the Marine Corps. Internal controls embedded in these support services either are not designed effectively or are not operating effectively. For example:



- The service provider's review of trial balance reconciliations was insufficient and ineffective, given that supervisory review and approval documentation was not maintained and a key review in third quarter (Q3) FY 2017 did not identify an error caused by the duplication of data imported into DDRS
- The service provider's abnormal balance analysis does not include a discussion of what business events led to the abnormal conditions and resolution and/or correction of abnormal balance conditions is not performed timely.

The Marine Corps' oversight of the third-party service provider is insufficient. We noted that not all of the data analysis or documents are reviewed or subjected to sufficient monitoring procedures by the agency. For example, the Marine Corps:

- Reviewed financial statements and disclosures produced by DDRS-AFS; however, the oversight function was limited to reviewing the abnormal financial statement line item and note balances identified by the service provider and providing explanations for those abnormal balances
- Did not perform sufficient and documented reviews of JVs and JV logs developed by its service provider
- Did not identify the duplication of data imported into one of the financial reporting systems
- Reviewed the draft version of the service provider's trial balance reconciliation noted above; the draft data did not include final adjustments to the financial statements.

The Marine Corps did not provide consistent and accurate data to support its financial reporting process. Specifically:

- The necessary data sets to recreate the opening balance financial statements and support recalculations of first quarter balances were not provided timely
- The supporting documentation for Q3 balances was not inclusive of all relevant fund symbols.

**Cause:** The Marine Corps and its service provider possess complex financial reporting process and systems configurations, which include the need for multiple data sources to recalculate or monitor financial reporting outputs and system limitations surrounding the process and production of documentation to support financial reporting. The GL system, SABRS, relies upon DDRS to accomplish year-end closing of period accounts and to crosswalk and supplement SABRS attributes; it does not fully comport with the USSGL. This situation is complicated by insufficient record-keeping, supervisory review and approval, and/or management oversight of third-party service providers and Marine Corps personnel.

The Marine Corps has not thoroughly evaluated its risk of material misstatement and established its internal controls over financial reporting, to include:

- Monitoring and oversight controls over its service provider



- Controls designed to respond to communicated complimentary user entity controls (CUEC)
- An effective process to perform analytical procedures in an effort to prevent, detect, and correct material misstatements.

In addition, the service provider, in coordination with the Marine Corps, has not executed a risk- and control-based analysis of its internal controls over financial reporting. In addition, standard operating procedures (SOP) are not current and/or do not reflect the control environment. Finally, the Marine Corps has not completed a comprehensive entity-level assessment of its compliance with GAAP.

**Effect:** Failure to perform a comprehensive gap analysis to determine, understand, and document the current level of compliance with GAAP increases the risk of incomplete and inaccurate presentation of financial statements and disclosures in accordance with GAAP and hinders the development of thorough corrective actions. Additionally, the Marine Corps may not identify and adequately prepare for new standards prior to the implementation dates. The Marine Corps also did not timely produce an accurate and complete Note 1, *Significant Accounting Policies*, disclosure.

Without effectively designed controls that are implemented and operating effectively, the Marine Corps may not detect and correct material misstatements and associated root causes in a timely manner. In addition, the financial statements and other external reports and underlying data may be materially misstated. For example:

- Due to improper asset type classification for Outstanding Contract Financing Payments, Other Assets were overstated and construction in progress (CIP) asset accounts were understated by \$83.4 million in Q3 FY 2017
- Q3 FY 2017 balances included undocumented, material variances in several accounts ranging from \$393 million to \$980 million (\$980 million in unexpended appropriations, \$490 million in AP and expenses, and \$393 million in appropriations used)
- The Marine Corps' analysis of its opening balances identified \$2.1 billion in Revolving Funds Available for Apportionment recorded in DDRS in FY 2010 for which SABRS was not the source, and the source has not been identified. The Marine Corps recorded a DDRS adjustment reversing the \$2.1 billion balance; however, the majority of the removed balance relates to funds that will not fully cancel until after FY 2018. This results in an increased risk of material misstatement due to completeness.

Additionally, the Marine Corps does not have sufficiently designed controls to address CUEC responsibilities, as intended by the service provider.

Finally, the financial statements or other reports are not compliant with applicable laws and regulations and the GL systems, and their configurations are not compliant with FFMIA.

**Recommendations:** Kearney recommends that the Marine Corps:

1. Establish procedures for periodic assessment and evaluation of its policies, processes, and procedures to ensure compliance with GAAP, including pending changes to GAAP and identifying potential departures from GAAP.
2. Complete an initial assessment to include which policies support GAAP implementation and departures from GAAP. Assess/quantify the impact of the departures from GAAP on its financial reports and disclosures, as well as develop corrective action plans (CAP) accordingly.
3. Maintain appropriate financial statement disclosures to alert users of external reports of the limitations of such reports as a result of departures from GAAP.
4. Research the root causes and correct the underlying business processes which result in abnormal balances. To the extent possible, correct the conditions in the reporting period in which they occurred. As needed, develop CAPs or plans of action and milestones (POA&M) to address items that require longer or more resource-intensive remediation support.
5. Conduct a comprehensive analysis of the current financial management, financial reporting, and analysis processes and controls to determine their effectiveness and reliability for the timely identification of conditions or events that lead to incorrect accounting treatment or result in noncompliance with laws and regulations. As part of this analysis, consider those controls performed by the third-party service provider.
6. Define roles and responsibilities with the service provider through an SLA that is routinely updated and maintained and considered within the overall financial reporting control environment, to include compensating controls performed by the Marine Corps.
7. Design, document, and implement a comprehensive control environment related to financial reporting with clear segregation of duties between the service provider and Marine Corps personnel. Develop a consistent process of reviewing the Marine Corps' financial reporting documentation accumulated by third-party service providers in support of GL monitoring, financial reporting, and other financial management support services. Provide sufficient training over the Marine Corps' financial reporting process to identify and correct errors and misstatements in a timely manner. The environment should include:
  - a. Controls to meet CUEC requirements and provide a sufficient level of oversight over service provider and Marine Corps data and reporting.
  - b. Review of quarterly financial statements and related disclosures for compliance with USSGL and OMB Circular A-136, with documented criteria and results.
  - c. Evidence that the controls are sufficiently designed and maintained to allow for documented management oversight and to support internal validation and external audit.
  - d. Update and expand the current reports and tools used to support review of the financial reporting documentation; consider staged reviews throughout the process to allow for timely monitoring and correction of errors, if noted.
  - e. Establish sufficient analytical procedures at the appropriation and account levels to support financial statement analysis and oversight of work performed by third-party service providers.

- f. Conduct a root cause analysis over JV adjustments and design appropriate CAPs to reduce the volume of JVs processed in DDRS, as well as establish a complete JV review and approval process that includes all manual and system-generated JVs prior to the closing of a reporting period. Analyze the root cause of the large volume of automated and manual JVs posting in DDRS and, accordingly, develop a CAP to limit the volume of data calls and other on-top adjustments by improving systems and business processes.
8. Work with its service providers to implement the recommendations provided below. If these changes affect other DoD components, work with leadership from those entities to identify and undertake broader remediation efforts, where appropriate.
  - a. Perform the complete accounting period closing in the GL, SABRS, rather than the reporting system.
  - b. Ensure that SABRS contains all attributes outlined in the TFM's USSGL Supplement, Section IV, *Account Attributes for USSGL Proprietary Account and Budgetary Account Reporting*.
  - c. Implement periodic review and updates to all posting logic and closing account pairings, including all pre-closing and closing entries relevant to the Marine Corps. Document the compliance reviews to include evidence of a supervisory review and approval. Maintain a listing of SABRS changes and any related system testing results.
  - d. Develop, implement, and document periodic reviews and updates of SABRS to DDRS crosswalk to ensure SABRS GLANs match appropriate USSGL accounts. Eliminate or deactivate line items that are no longer used.
  - e. Ensure SABRS fully records trading partner information so that the reconciliation and resolution of unaligned balances are researched, adjusted, and supported at the transaction level. Emphasize communication between trading partners when researching differences, not assuming the "seller-side" is always correct without exchange of detailed information. Include a narrative to discuss the approach (e.g., communication, information exchange, calculations, assumptions) taken to arrive at any reporting adjustments.

### C. Accounting for Estimates

**Condition:** The Marine Corps' deficiencies related to accounting for estimates concern the completeness and accuracy of estimates for AP, contingent legal liabilities, and civilian labor accruals. We noted the following:

- The AP accrual methodology used to prepare a \$531 million opening balance estimate is insufficient. The methodology has insufficient input controls for disbursement data and excludes certain relevant transaction types when calculating the accrual. In addition, the methodology incorporates an unreliable input into the estimation methodology (i.e., the lag factor used to identify disbursements for inclusion in the accrual calculation is unreliable and imprecise), double-counts transactions by estimating accrual amounts for transactions that have already been recorded as specifically identified AP in SABRS, and insufficiently assesses the validity of the accrual in the subsequent accounting period by



- not assessing actual liquidations of estimated payables or accounting for the heterogeneous nature of the Marine Corps' various business processes
- The Marine Corps' business processes related to the accumulation and reporting of contingent legal liabilities have not been designed to achieve the necessary financial reporting objectives. Specifically, individual cases below the materiality threshold are not evaluated and assessed for materiality in the aggregate, and Marine Corps management does not perform, or has been unable to provide, an assessment of the case information provided in the legal representation letter and for cases below the materiality threshold
  - Civilian labor accruals enable the Marine Corps to meet monthly financial reporting requirements and ensure amounts are obligated for management of budgetary resources, but the Marine Corps lacks assurance that accrued amounts are correct. Commands are updating the daily civilian labor accrual rate in SABRS inconsistently and untimely.

**Cause:** The Marine Corps does not have the necessary processes and controls to ensure the completeness and accuracy of financial statement line items and disclosures resulting from various accounting estimates. Specifically:

- The AP estimation process does not include controls and procedures to determine the relevance or reliability of input data to the accrual estimate methodology. In addition, the methodology was not effectively designed
- The reported contingent legal liability is incomplete and the resulting disclosures are not accurate because management lacked sufficient information regarding the complete population of pending or threatened litigation, claims, or unasserted claims. Without this information, and as a result of insufficient policies and procedures in place over the coordination between the legal and accounting personnel, the Marine Corps cannot develop the necessary liability and disclosure and perform management's review and evaluation of litigation, claims, and assessments for recording and/or disclosure in the Marine Corps' financial statements
- The civilian payroll labor accruals lack centralized oversight for amounts recorded by individual Commands and do not have central and periodic reviews of their sufficiency.

**Effect:** Without effectively designed, implemented, and/or operating controls, the Marine Corps has increased risk of material misstatement and noncompliance with laws and regulations, including FFMIA. During the course of our audit work, Kearney noted:

- The Non-Federal AP balance as of September 30, 2016 may be overstated by an estimated \$91 million of double-counted transactions between SABRS and the accrual estimate within the Accounts Payable line item
- The Marine Corps' inability to demonstrate the validity of its accrual and dates of its expenses prevents it from demonstrating the fair presentation of its opening AP balances
- The Marine Corps lacks assurance that contingent legal liabilities recorded and disclosed in the financial statements and related notes are complete, accurate, and presented in accordance with GAAP.

**Recommendations:** Kearney recommends that the Marine Corps:

1. Update its AP accrual methodology documentation to require validation of inputs; corrections for double-counting; re-assessment of transaction types included in and excluded from the estimate to determine if aggregated transactions have a significant effect on the estimate; re-visitation of its analysis and identification of other factors to enhance its AP accrual estimate; and a process for validating the estimate against actual results.
2. Define roles and responsibilities for the evaluation of litigation, claims, and assessments for financial reporting purposes and work with the Office of General Counsel to develop sufficient reports or other support to aid management in completing its review of and conclusion on the contingent legal liability to be reported in the financial statements and note disclosures. Additionally, the Marine Corps should develop and implement policies and procedures for obtaining case information and performing assessments of the likelihood of unfavorable outcomes, to include probable, reasonably possible, and remote, along with estimates or ranges of estimates for financial reporting in accordance with GAAP.
3. Develop and implement a standard methodology for calculating, preparing, documenting, and reviewing civilian payroll labor accrual rates entered in SABRS, including the frequency with which accrual input data should be re-evaluated.
4. Develop and implement policies and procedures for centrally and periodically reviewing the sufficiency of its civilian payroll labor accruals, to include consideration of actual amounts paid for the corresponding period of the accrual, to ensure labor liability amounts are recorded based on an approved methodology and are materially correct. Evaluate automating the civilian labor accrual as a centralized process to increase the efficiency of periodically reviewing the sufficiency and accuracy of the accrual.
5. Provide training to Command-level personnel responsible for preparing and approving civilian payroll labor accruals, including training related to updated policies and procedures and documentation requirements.

**IV. Integrated Financial Management Systems (New Condition)**

Deficiencies in four related areas define this material weakness:

- A. SABRS interface controls
- B. SABRS to SMARTS reconciliations
- C. Feeder systems to SABRS reconciliations
- D. Integration between APSRs and SABRS.

**Background:** Business process application-level controls provide reasonable assurance about the completeness, accuracy, validity, and confidentiality of transactions and data during application processing. Completeness controls should provide reasonable assurance that all transactions are recorded in the system, accepted for processing, processed only once by the system, and properly included in financial reports. Completeness controls include the following key elements:

- Transactions are completely input/interfaced
- Valid transactions are accepted by the system
- Duplicate postings are rejected by the system
- Rejected transactions are identified, corrected, and re-processed
- All transactions accepted by the system are processed completely.

The Marine Corps uses a wide array of feeder (i.e., source) systems to generate and capture financial transactions for recording in SABRS (e.g., core financial management system). SABRS receives and sends multiple interfaces from and to multiple partners. Each interface partner holds an Interconnection Security Agreement and/or Memorandum of Agreement (MOA), which defines how every system is processed and reconciled, as well as how interconnections are used. The system MOAs define the edits, validations, error corrections, and communication methods for each interface. A number of DoD components maintain systems that interface with SABRS for processing, updating data, and retrieving reports. SABRS receives much of its data from source system (i.e., feeder system) interfaces that supply the raw data that SABRS processes. In addition, SABRS provides outbound interfaces with SMARTS used to provide management with financial reports.

The Marine Corps' capital expenditures, are recorded in SABRS as operating expenses. Marine Corps capital expenditures consist of the procurement of PP&E and certain types of OM&S, which the Marine Corps records upon acquisition into an APSR. Quarterly, the Marine Corps compiles asset data from each APSR to record a JV to capture PP&E and OM&S activity (e.g., receipts, disposals, transfers). The JV is recorded outside of SABRS, directly into DDRS-AFS, and is intended to correct capital expenditures improperly recorded in the operating expense account.

In a non-integrated systems environment, reconciliation of account balances is an important internal control and critical to financial integrity. Reconciliation of GL balances to detailed subsidiary ledger and source (i.e., feeder) system balances and activity enables ongoing monitoring of account balances; promotes the recording of business transactions in a complete, accurate, and timely manner; and provides an audit trail. An effectively designed reconciliation process includes comparing GL balances to subsidiary ledger and feeder system balances; researching account variances; analyzing and supporting reconciling items, to include identifying root cause with the intent to reduce overall volume of reconciling items over time; correcting reconciling items timely; and performing reviews and approvals.

## A. SABRS Interface Controls

**Condition:** The Marine Corps does not have a mechanism in place to identify duplicate files sent from source systems to SABRS. In addition, the Marine Corps does not have a record count reconciliation for files processed in SABRS from external sources on a non-routine basis (i.e., sequential files).

The Marine Corps developed and implemented system change requests (SCR) to add a SABRS control to prevent duplicate files from being processed and to reconcile the record counts for the sequential files; however, those SCRs were not subjected to audit procedures.

**Cause:** The Marine Corps did not configure SABRS to identify or prevent the processing of duplicate files. Currently, management's error controls (e.g., errors for unmatched records) within SABRS do not prevent duplicate transactions. Sequential files are not included in the daily record count reconciliation because they occur at random times (e.g., not daily).

**Effect:** By allowing the processing of duplicate transactions, there is an increased risk of incorrect/inaccurate processing of Marine Corps transactions, which may result in the misstatement of financial balances. The design of transaction data elements is a critical factor in helping to assure the integrity of data, as well as its interrelationship with other data elements.

**Recommendations:** Kearney recommends that the Marine Corps:

1. Continue to develop and implement the current system changes to facilitate the reconciliation of transaction counts for sequential files.
2. Monitor the reconciliation of transactions and balances to verify SMARTS is properly recognizing and reconciling the daily and sequential files.
3. Develop policies, procedures, and process narratives, as applicable, to outline the sequential file reconciliation process and establish purpose, scope, roles, responsibilities, management commitment, and coordination among organizational entities.
4. Continue to implement the SABRS SCRs to ensure that all transactions are accepted and processed only once.
5. Incorporate the duplicate files handling into the SABRS Feeder System Manual and any other relevant policies and procedures.
6. Monitor the duplicate file handling process to verify effective operation.

## B. SABRS to SMARTS Reconciliation

**Condition:** The Marine Corps does not perform and does not sufficiently document a complete reconciliation between SABRS and SMARTS. The Marine Corps reconciles the number of transactions in the interface files but does not directly reconcile the dollar values between SABRS and SMARTS data. SABRS does not provide a flexible, inexpensive, and easily accessible reporting function; as such, the Marine Corps relies on SMARTS, a query tool, to provide financial information to stakeholders for analysis, decision-making, and JV support.



SMARTS does not directly access SABRS; instead, SMARTS receives daily transmissions from SABRS.

**Cause:** The Marine Corps relied on record counts of interface files to detect inconsistencies between SMARTS and SABRS. However, this would not capture differences resulting from transactions or balances not included in the interface files from SABRS. Prior to Q2 FY 2017, the Marine Corps' controls designed to detect irregularities between SABRS and SMARTS were inadequate.

**Effect:** Without complete reconciliations of transactions and balances between SABRS and SMARTS, the risk increases that SMARTS data is incomplete and/or inaccurate. Without a process in place to fully reconcile all data transmitted from SABRS to SMARTS, there is an increased risk that the data within SMARTS is not complete or accurate. This could result in misstatements of financial balances.

**Recommendations:** Kearney recommends that the Marine Corps:

1. Develop, document, and perform a monthly reconciliation between SMARTS and SABRS that includes account balances, fund symbols, and/or other relevant data elements, as well as the record counts and dollar values to evidence that SABRS properly transmits transactional data to SMARTS.
2. Document compensating controls, assess the appropriateness of the controls (whether key or compensating), evidence completion of these controls, and fully document all controls within a month-end reconciliation process SOP.
3. Perform a review of the reconciliation control and evidence it at the appropriate level.

Upon notification of this deficiency, the Marine Corps submitted requests to the systems program office to implement and document the direct dollar and count reconciliations between SABRS and SMARTS and began documenting its compensating controls; however, the results of these actions were not implemented at the time of our testing.

### C. Feeder Systems to SABRS Reconciliations

**Condition:** The Marine Corps uses a wide array of feeder (i.e., source) systems to generate and capture financial transactions for recording in SABRS (e.g., core financial management system or GL system). The Marine Corps does not maintain sufficient internal controls to ensure interface feeder systems confirm that transactions received by SABRS are complete and in agreement with the transmitted interface data. Moreover, the Marine Corps does not have sufficient periodic reconciliations of non-payroll-related balances and/or activity between SABRS and the feeder systems or another mechanism to validate the completeness and accuracy of the interface data at a given point in time and over the course of the FY. In addition, we noted that Marine Corps Commands did not consistently reconcile approved ServMart supply and fuel purchases to recorded transactions using SMARTS reports. The Commands that performed a reconciliation did not adequately document it.



For military payroll, the Marine Corps performs several steps to verify the accuracy of the interfaces between MCTFS and SABRS; however, centralized oversight and monitoring of these processes are not in place. Additionally, the Marine Corps has not evidenced a comprehensive detail to gross pay monthly reconciliation, including supervisory review and approval, between MCTFS and SABRS.

For civilian payroll, we noted that the Marine Corps does not always document supervisory review and approval of biweekly reconciliations between the timesheet system, Standard Labor Data Collections and Distribution Application, and the payroll system, Defense Civilian Pay System (DCPS). In addition, the Marine Corps does not have a clearly documented, centralized review and approval process over the reconciliation to identify employee pay and benefits participation discrepancies between the personnel data system, Defense Civilian Personnel Data System, and DCPS. The Marine Corps does not calculate the financial statement effect of reconciling items.

**Cause:** The Marine Corps' policies and procedures do not detail reconciliation requirements, including those for documentation and supervisory review and approval and centralized oversight with respect to certain key reconciliations.

**Effect:** Without effectively designed, comprehensive reconciliations, the Marine Corps does not have assurance over the completeness and accuracy of recorded transactions and, in some cases, is unable to quantify the effect of discrepancies on the financial statements. Specifically:

- All business events and transactions initiated in feeder systems were sent to SABRS
- All feeder system transactions sent to SABRS were received by SABRS
- Transactions recorded in SABRS from feeder systems are properly supported by feeder systems and are only recorded in SABRS once
- Applicable CUECs over the review of completeness and accuracy of feeder system output are in place and operating effectively.

**Recommendations:** Kearney recommends that the Marine Corps:

1. Identify the military payroll and non-payroll SABRS feeder systems that are key to the Marine Corps' financial reporting objectives.
2. Develop and implement policies and procedures for periodic reconciliations of balances between key feeder systems and the SABRS GL. Consider opportunities to implement IT solutions to automate such procedures.
3. Evaluate controls to ensure the design is in accordance with CUECs defined for users of feeder systems.
4. Develop and implement SOPs to establish the Marine Corps' timely monitoring and oversight of the current processes performed by the various entities involved in the military payroll process. SOPs should include the requirements for evidencing reconciliations, as well as descriptions of how changes are communicated and verified and how the overall review process and approval of these controls are completed by Marine Corps management.

5. Evaluate and update policies and procedures for civilian payroll-related reconciliations, including, as appropriate, requirements for calculation and evaluation of the financial statement impact of unresolved discrepancies and reviews and approvals.

#### **D. Integration between Accountable Property Systems of Record and SABRS**

**Condition:** The Marine Corps' accounting operations for recording PP&E and OM&S activity, in which SABRS is bypassed with quarterly JVs directly into DDRS, contributed to several conditions. Specifically, the Marine Corps:

- Does not have a unique identifier to systematically differentiate capital expenses from non-capital expenses within SABRS. Kearney could not verify, through substantive testwork of expenses, the accuracy of quarterly PP&E and OM&S JVs recorded to offset the Marine Corps' gross costs by capital activity
- Does not have a process in place to track and accumulate CIP expenditures to be applied to individual assets based on accumulated program costs. The Marine Corps' cost accumulation process is not segregated by individual CIP asset, but rather is accumulated in aggregate across Marine Corps programs
- Does not record in the real property APSR capital renovation and improvement projects related to real property funded using Operations and Maintenance appropriations until the project is complete. In addition, these projects are not accumulated through the quarterly data call process for capitalization in the Marine Corps' financial statements
- Did not provide a detailed listing for OM&S ammunition, temporary storage project, and set assembly balances and supportable reconciled universe of transactional information (e.g., issues, receipts, losses, gains) to the on-hand quantities generated from OM&S APSRs. See further details in Section VI, *Accounting for Operating Materials and Supplies*.

**Cause:** The Marine Corps has not established an interface between SABRS and disparate APSRs in which birth records for finished goods originate. In addition, the Marine Corps' current process for capturing capital activity for financial reporting purposes relies exclusively on the accuracy and timeliness of data captured in APSRs. The current process design does not allow for reconciliation between the Marine Corps' APSRs and the SABRS GL. Additionally:

- The Marine Corps does not have adequate processes in place to identify expenditures which qualify for capitalization, nor business rules established within SABRS to allow for a posting model to accumulate capitalized expenditures in appropriate GL accounts
- The Marine Corps does not currently have the reporting capability to provide a supportable, reconciled listing for OM&S balances or supportable, reconciled transactional information.

**Effect:** The lack of an interface between the Marine Corps' APSRs and SABRS results in an inability to differentiate between capital expenditures and non-capital expenditures within SABRS. In addition, the Marine Corps cannot determine whether capital and non-capital expenditures are fairly presented in the financial statements. Specifically, the Gross Costs on the



Statement of Net Cost may be overstated and Inventory and Related Property and General PP&E on the Balance Sheet may be understated as a result of improper classification of capital expenditures.

Without a process to formally accumulate CIP expenditures by asset project, CIP may be valued at incorrect amounts. Similarly, upon completion of the asset construction, the transfer of costs between CIP and finished goods may be recorded at incorrect amounts, resulting in improperly valued assets.

As explained in Section VI, *Accounting for Operating Materials and Supplies*, the scope of our audit was limited since we were unable to perform auditing procedures required under professional standards over OM&S.

**Recommendations:** Kearney recommends that the Marine Corps:

1. Develop policies and procedures to appropriately identify and record capital expenditures using the USSGL and work towards reducing the need for quarterly JVs to capture capital expenditures.

Until which time the Marine Corps can establish an effective interface between the multitude of APSRs in use for PP&E and OM&S, to accurately capture transactional level data in the core accounting system, and to properly accumulate capital expenditures in SABRS, in accordance with USSGL requirements, the Marine Corps should:

2. Develop formalized cost classification and accumulation policy and procedures. The policy should detail the requirements for cost capitalization in accordance with applicable accounting standards for PP&E and OM&S.
3. Establish a unique identifier (e.g., transaction code or document type) within SABRS to be used for capital expenditures. This should be inclusive of direct procurement of capital PP&E finished goods, OM&S finished goods acquisitions, PP&E CIP, and OM&S work in process (WIP).
4. Update SABRS posting logic for capital expenditures to comply with USSGL Treasury Guidance. SABRS business rules should be established for capital expenditures to be recorded directly to appropriate asset accounts.
5. Analyze capital activity on a monthly basis to verify all expenditures represent capital activity and appropriate classifications have been recorded for PP&E versus OM&S.
6. Establish formalized quarterly reconciliation procedures between PP&E and OM&S APSRs and the activity recorded in SABRS.

## V. Accounting for Property, Plant, and Equipment (New Condition)

Deficiencies in two related areas define this material weakness:

- A. Existence and Completeness of PP&E
- B. Valuation of PP&E.

**Background:** The Marine Corps owns and operates a diverse portfolio of PP&E, with significant asset classes including real property and general equipment. The Marine Corps categorizes its general equipment in two sub-asset classes: 1) military equipment, inclusive of weapon systems and related support equipment, and 2) garrison property/garrison mobile equipment (garrison property), which includes non-military equipment.

In August 2016, FASAB issued a new Federal accounting pronouncement, SFFAS No. 50, *Establishing Opening Balances for General Property, Plant, and Equipment*, amending existing PP&E accounting standards to allow a reporting entity, under specific conditions, to apply alternative valuation methods in establishing opening balances for PP&E. The alternative valuation methods available under SFFAS No. 50 may be applied in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements are presented fairly in accordance with GAAP. As SFFAS No. 50 is applicable to the valuation of opening balances only, all changes to the Marine Corps PP&E portfolio as a result of current-year transactions, are subject to the valuation requirements set forth in SFFAS No. 6, *Accounting for Property, Plant, and Equipment*.

In FY 2017, the Marine Corps withheld its unreserved assertion for the effective implementation date for SFFAS No. 50, allowing the alternative valuation methods available under SFFAS No. 50 to continue in future periods until Marine Corps internal controls are in place to adequately account for PP&E going forward in accordance with SFFAS No. 6.

As part of our opening balance testwork for PP&E, we performed physical observation of assets to verify existence and completeness of the Marine Corps' PP&E, as well as assessed the Marine Corps' valuation of PP&E. Kearney's testwork was performed across each significant asset class, including real property, military equipment, and garrison property.

### A. Existence and Completeness of PP&E

**Condition:** The Marine Corps did not demonstrate sufficient existence and completeness of its recorded PP&E. Kearney selected samples from each of the Marine Corps asset classes for opening balances testing. Our testing results identified:

- The Marine Corps did not locate approximately 9% of the tested assets for physical inspection or did not provide sufficient appropriate evidence, including asset photographs and/or other key supporting documentation, to support the existence of the asset as of October 1, 2016



- The Marine Corps did not provide sufficient or complete supporting documentation for approximately 10% of the tested assets, which prevented us from concluding on the existence of the assets as of October 1, 2016
- The Marine Corp did not record approximately 5% of the tested assets, which were selected while performing testwork at Marine Corps installations and bases, in the beginning balance as of October 1, 2016 (i.e., completeness of the Marine Corps assets)
- The Marine Corps did not provide sufficient appropriate evidence to allow us to conclude on the completeness of approximately 4% of the tested assets, which were selected while performing testwork at Marine Corps installations and bases
- The Marine Corps could not provide evidence of the last time the assets were included in an inventory count for approximately 30% of our tested items.

**Cause:** The Marine Corps had inventory management controls that were not effectively operating, inaccurate reporting of assets within APSRs, and ineffective retention of supporting documentation.

**Effect:** Ineffective inventory management controls results in the loss of accountability for asset custodianship and inaccuracies in the Marine Corps' financial statements. Based on the known exceptions from the results of our existence and completeness testing, the Marine Corps misstated the opening balance of PP&E. In addition, Kearney was unable to conclude on approximately 14% of our sample items, which may represent additional, potential misstatements to the PP&E opening balance. Kearney has provided additional information over the dollar impact of our testing results in the PP&E valuation discussion, as provided below.

The results of existence and completeness testwork over PP&E prevent Kearney from concluding that the PP&E line item on the Balance Sheet is fairly stated as of September 30, 2017.

**Recommendations:** Kearney recommends that the Marine Corps:

1. Continue efforts to strengthen the operational effectiveness of inventory management controls to improve the overall accountability of PP&E and the accuracy of property data within APSRs used for financial reporting purposes.
2. Implement the necessary training across all installations to increase the knowledgebase and understanding of acceptable supporting documentation for the financial statement audit. Training should include lessons learned from the FY 2017 audit, the use of digital photographs to evidence and support existence, and documentation retention practices.

Considering the Marine Corps' diverse PP&E portfolio, Kearney's recommendations regarding real property include:

3. Produce formalized Real Property Accountable Officer (RPAO) inventory schedules on an annual basis and submit them to Marine Corps Installation Command (MCICOM). The inventory schedule should include a 12-month plan of all real property to be physically observed in the current FY. During quarterly data calls for financial reporting,

the status of the annual inventory schedule should be provided to MCICOM to monitor the overall execution of the real property inventory.

4. Incorporate annual floor-to-book inventory requirements into RPAO inventory control plans. All real property assets on a Marine Corps installation, including those reported by non-Marine Corps components, should have readily available supporting documentation to evidence the ownership and user determinations as it pertains to financial reporting.
5. Verify, during inventory procedures, that all real property assets are physically marked with visible signage.

Further, Kearney's recommendations for general equipment (i.e., military equipment and garrison property) include:

6. Perform a final assessment of available supporting documentation based on known audit testing exceptions. Adjustments to the APSR should be recorded to remove known existence exceptions and add any remaining known completeness exceptions.
7. Perform an assessment of the complete asset portfolio included in the financial statements as of September 30, 2017 to verify all assets are appropriately aligned to a Supply Officer and, thus, included in the quarterly inventory process.
8. Incorporate quarterly floor-to-book inventory requirements for capital assets into the inventory control plans for each Supply Officer.
9. Increase frequency of the capital inventory in the Marine Corps Logistics Command's physical inventory control program. Quarterly inventory requirements should be implemented until which time the inventory results reflect effective implementation of business processes and associated internal controls, specifically associated with the conversion to GCSS – Marine Corps (MC) as the new APSR.

## **B. Valuation of PP&E**

**Condition:** The Marine Corps' PP&E valuation as of September 30, 2017 is not in accordance with GAAP. The Marine Corps did not value current-year PP&E activity in accordance with SFFAS No. 6, and the Marine Corps' valuation of opening balances of PP&E using alternative valuation methods available in accordance with SFFAS No. 50 remains in process as of September 30, 2017. As a result:

- The Marine Corps recorded significant adjustments to its PP&E opening balance, resulting from its efforts to bring assets to record, remove assets which no longer exist, determine Marine Corps ownership, determine capital versus non-capital classification, and perform valuation under SFFAS No. 50, which was not complete at the start of FY 2017. The adjustments primarily represent changes to opening balances; however, the Marine Corps elected to process the adjustments through the current year in a departure from the prescribed accounting treatment in SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, Amendment of SFFAS 7, *Accounting for Revenue and Other Financing Sources*, and OMB Circular A-136. These adjustments totaled over:
  - \$1.6 billion in real property adjustments as of June 30, 2017

- \$504 million in general equipment (military equipment) adjustments as of June 30, 2017
- \$510 million in general equipment (garrison property) adjustments as of June 30, 2017
- The Marine Corps' recorded values associated with opening balances were materially misstated as a result of errors identified during existence testwork, capital property misclassification errors, ownership errors, and errors identified in the alternative valuation methods using the supporting documentation provided. These errors resulted in:
  - Overstatements of approximately \$616 million across 35% of tested real property sample items. Kearney also encountered 34 sample items for which we could not draw a conclusion based on the evidence provided, resulting in a potential overstatement of \$419 million
  - Overstatements of approximately \$92 million across 37% of tested general equipment (military equipment) sample items. In addition, Kearney was unable to conclude on 52% of our sample items based on the evidence provided, resulting in a potential overstatement of \$288 million
  - Overstatement of \$127 million across 67% of general equipment (garrison property) sample items. In addition, Kearney was unable to conclude on 25% of our sample items based on the evidence provided, resulting in a potential overstatement of \$112 million
- The Marine Corps did not use the latest available information in calculating plant replacement value (PRV) for its valuations for real property. The Marine Corps incorrectly used an outdated version of the Uniform Facilities Criteria (UFC) DoD Facilities Pricing Guide to calculate PRV. Kearney requested that the Marine Corps perform an analysis of the impact of using the incorrect version. The Marine Corps determined that the original valuation calculated was understated by approximately \$2.3 billion. Kearney did not audit the impact of the Marine Corps' determination and the corresponding adjustment recorded by the Marine Corps for the error
- The Marine Corps used historical data retrieved from legacy information systems among several estimation techniques for deemed cost. The Marine Corps provided Kearney with data screenshots from the legacy information systems to evidence the historical data. However, the Marine Corps was unable to demonstrate to Kearney that historical data from these systems was reliable and appropriate for valuation under SFFAS No. 50. This impacted 48% of the military equipment sample items tested.

**Cause:** With the Marine Corps' election to begin the implementation of SFFAS No. 50 for PP&E valuation in FY 2017, there have not been effective business processes, internal controls, and information systems in place to accurately value PP&E in accordance with SFFAS No. 6. The Marine Corps' inventory management controls are not operating effectively to accurately capture the agency's PP&E portfolio. The Marine Corps' inventory management controls were not operating effectively to accurately capture the agency's PP&E portfolio within various APSRs in use for FY 2017.



Additionally, the Marine Corps does not have a current process in place to monitor UFC DoD Facilities Pricing Guidance to verify that the most current pricing information is in place prior to calculating real property valuation for financial reporting purposes.

Finally, the Marine Corps has not fully implemented business processes with effective internal controls to support general equipment asset valuation under SFFAS No. 50 that can be evidenced with sufficient supporting documentation necessary for audit.

**Effect:** The Marine Corps was unable to accurately and appropriately value its PP&E assets for FY 2017 and withheld its unreserved assertion for SFFAS No. 50. Kearney cannot conclude that PP&E is fairly stated in accordance with GAAP as of September 30, 2017. The Marine Corps' PP&E as of September 30, 2017 does not reflect historical cost as required by SFFAS No. 6, and the Marine Corps' opening balances for FY 2017 do not reflect historical cost under alternative valuation techniques as allowable under SFFAS No. 50. The PP&E valuation and associated depreciation may be materially misstated as presented within the Marine Corps' financial statements.

**Recommendations:** Kearney understands that the Marine Corps began re-baselining its real property portfolio and revaluing all real property using the UFC DoD Facilities Pricing Guidance effective for FY 2017 as part of the Marine Corps' continued implementation of SFFAS No. 50. In addition to this re-baselining effort, Kearney recommends that the Marine Corps:

1. Verify all RPAOs are aware of the latest valuation re-baseline and update planned inventory schedules to include real property assets that exceed the capitalization threshold as a result of the re-baseline.
2. Obtain guidance for the implementation of significant accounting policy revisions, in consultation with the OUSD(C), while FASAB considers the OUSD(C) request for modifications to property accountability accounting standards promulgated by FASAB. As the Marine Corps has moved forward with removing real property assets based on the OUSD(C) Exclusive Use Policy, identify potential assets that will likely be identified as the agency's responsibility for financial reporting purposes and be prepared to record adjustments, as necessary.
3. Develop and implement monitoring procedures over system changes to the real property APSR which may affect the valuation of real property assets. The Marine Corps should obtain all system changes on a monthly basis from Naval Facilities Engineering Command.
4. Require pertinent data fields be populated within the APSR to ensure compliance with relevant accounting standards.
5. Establish and implement policies for retaining real property asset records, which support real property transactions to move towards compliance with valuation requirements of SFFAS No. 6.

Kearney recommends that the Marine Corps continue implementation efforts of SFFAS No. 50 for the opening balance of FY 2018 associated with general equipment, both military equipment and garrison property. The Marine Corps should strengthen the business processes and

associated internal controls surrounding the development of valuation techniques allowable under SFFAS No. 50 and the supporting documentation behind valuation determinations. Specifically, the Marine Corps should:

6. Work with Program Managers to strengthen the alternative valuation support in accordance with SFFAS No. 50. The valuation determination must be clearly traceable to supporting documentation maintained in an asset file. The asset file should include a valuation worksheet signed by the preparer and certified by the asset Program Manager.
7. Revisit all general equipment assets valued using legacy information systems to provide acquisition cost and/or placed-in-service date estimations. Using the valuation worksheet recommended above, adequately support valuation determinations made and verify that the valuation technique is in accordance with SFFAS No. 50. Reference to SFFAS No. 50 implementation guidance from FASAB should be made for all valuation techniques developed and implemented.
8. Develop preventative internal controls to ensure the appropriate asset classification is recorded in relevant APSRs. A formalized review and approval of asset classification determinations should be made prior to asset records being established in the APSR. Assessment and reconciliation efforts should continue to further identify any Research, Development, Test, and Evaluation assets which have been incorrectly classified as capital assets.

## **VI. Accounting for Operating Materials and Supplies (New Condition)**

Deficiencies in two related areas define this material weakness:

- A. Populations and Transactional Data
- B. Valuation for OM&S.

**Background:** In FY 2017, the Marine Corps reported approximately \$11.0 billion in Inventory and Related Property on its Balance Sheet. This balance consists of OM&S, with the primary asset classes being ammunition, set assembly, temporary storage projects, consumables, and repairables. The Marine Corps faces logistical and financial reporting challenges for OM&S, resulting from global operations and mission requirements.

In January 2016, FASAB issued a new Federal accounting pronouncement, SFFAS No. 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*, amending existing OM&S accounting standards to allow a reporting entity, under specific conditions, to apply alternative valuation methods in establishing opening balances for OM&S. The Marine Corps has elected to implement the alternative valuation methods in establishing opening balances for OM&S, in accordance with SFFAS No. 48. As SFFAS No. 48 is applicable to the valuation of opening balances only, all changes to the Marine Corps OM&S portfolio as a result of current-year transactions, are subject to the valuation requirements set forth in SFFAS No. 3, *Accounting for Inventory and Related Property*.



The alternative valuation methods available under SFFAS No. 48 may be applied in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements are presented fairly in accordance with GAAP. In FY 2017, the Marine Corps withheld its unreserved assertion for its effective implementation date for SFFAS No. 48, allowing the alternative valuation methods available under SFFAS No. 48 to continue in future periods until the Marine Corps' internal controls are in place to adequately account for OM&S going forward in accordance with SFFAS No. 3.

#### **A. Populations and Transactional Data**

**Condition:** The Marine Corps was unable to provide a universe of transactions for current-year ammunition activity (i.e., production receipts, issuances, transfers) for its reported \$9.5 billion of ammunition in the opening FY 2017 balance of OM&S, which comprised 77% of the agency's opening OM&S balance. The Marine Corps provided its Quarterly Valuation Report, containing on-hand quantities for each ammunition National Stock Number (NSN) with corresponding unit price information for each NSN, rather than the transactional data requested that was necessary for audit procedures.

In addition, the Marine Corps was unable to provide a supportable, reconciled listing for OM&S balances or supportable, reconciled transactional information (e.g., issues, receipts, losses, gains) to the on-hand quantities generated from APSRs for temporary storage projects and set assembly. The Marine Corps reported that \$1.8 billion of temporary storage projects and set assembly (\$391 million and \$1.4 billion, respectively) comprised 14% of the Marine Corps' FY 2017 OM&S opening balance.

Additionally, reconciliations between Marine Corps and third-party custodians are not occurring for Marine Corps-owned OM&S inventory held in the custody of a third party.

**Cause:** The Marine Corps does not have the reporting capability within the Ordnance Information System – Marine Corps (OIS-MC) to produce timely ammunition production receipts and issuance expenditures which can be reconciled to variances between quarterly reported ammunition quantities. OIS-MC can produce historical transaction information; however, the transactional data must be manually reconciled to quarterly reported variances of ammunition. Such quarterly reconciliations of transactional data have not been part of the Marine Corps' programmatic and operational needs to date and were not performed.

The Marine Corps informed us that OIS-MC was undergoing an upgrade, which would enable the information system capability to produce the Q1 and Q2 transactional data populations. However, as of September 30, 2017, the Marine Corps was unable to produce the requested data population.

In addition, APSR limitations are a contributing factor in the Marine Corps' inability to provide a supportable, reconciled listing for OM&S non-ammunition balances or supportable, reconciled transactional information. The Marine Corps communicated to us that the temporary storage projects and set assembly APSR, Defense Property Accountability System – Warehouse

Management System (DPAS-WM) development began in FY 2011 and was fielded and implemented in FY 2015. However, a decision was made to implement DPAS-WM prior to the system functionality being confirmed as ready. Due to this decision, DPAS-WM has limited inventory capabilities, along with missing management reports. In addition, inaccurate inventory data was used in the DPAS-WM implementation, which continues to cause current data inaccuracies for the Marine Corps' OM&S. In FY 2017, the Marine Corps began a system migration from DPAS-WM to GCSS-MC as the APSR for OM&S temporary storage projects and set assembly.

Furthermore, the Marine Corps has not completed a substantiated wall-to-wall inventory for OM&S held at Marine Corps remote storage activities. OM&S held at remote storage activities are not supported by an executed and validated physical inventory control program.

The Marine Corps also has not designed and implemented business processes with an effective system of internal control to properly account for OM&S inventory held in the custody of third-party custodians.

**Effect:** The Marine Corps' inability to produce reconciling transactional data for ammunition impedes its ability to reconcile ammunition quantities observed during a point in time to opening balances and year-end balances. As a result of the Marine Corps' inability to provide quarterly data populations of OM&S temporary storage projects and set assembly transactions, the Marine Corps could not demonstrate the fair presentation of OM&S.

Without effective business processes and associated internal controls in place at Marine Corps' remote storage activities for physical inventory of assets, as well as the Marine Corps' accountable property held by third-party custodians, the Marine Corps cannot accurately maintain its APSR. In turn, quarterly APSR data provided by the Marine Corps' remote storage activities for the purposes of financial reporting is not accurate and cannot be relied upon.

**Recommendations:** Kearney recommends that the Marine Corps:

1. Finalize upgrade efforts to OIS-MC and test the capability to retrieve ammunition lot data from field-level ammunition APSRs, resulting in transactional details for ammunition production receipts and issuance expenditures.
2. Formalize quarterly transactional reconciliation procedures of ammunition receipts, issues, transfers, and disposals within OIS-MC to variances between quarterly reported ammunition quantities from ammunition custodians, including third-party custodians. Quarterly transactional activity should be reconciled to quarterly OM&S inventory quantities at the lot number/serial number by NSN. The quarterly reconciliation should be certified with a signature by appropriate personnel to evidence review and approval.
3. Continue audit remediation efforts to establish a complete and recurring effective inventory control program. The Marine Corps should consider a higher frequency of inventory procedures at remote storage activities (e.g., monthly and quarterly inventory procedures) than what is required under governing directives until which time the inventory results demonstrate that a minimum 98% physical inventory accuracy rate is

- achieved, as required by Department of Defense Instruction (DoDI) 5000.64, *Accountability and Management of DoD Equipment and Other Accountable Property*.
4. Continue the quarterly on-site assessments of audit readiness at Marine Corps' remote storage activities performed by the Marine Corps' Enterprise Ground Equipment Manager Internal Controls and Audit Readiness Team. Detailed assessments and reporting should be provided over the status of the Marine Corps' remote storage activities remediation efforts based on certified CAPs.
  5. Finalize migration efforts for the transition of the Marine Corps' remote storage activity APSR to GCSS-MC. The migration effort should verify that all required and critical data fields necessary for effective inventory management are accommodated by the transition to GCSS-MC.
  6. Formalize quarterly transactional reconciliation procedures of OM&S issues, receipts, losses, and gains. Quarterly transactional activity should be reconciled to quarterly OM&S inventory quantities by NSN and serial number. The quarterly reconciliation should be certified with a signature to evidence the completion.
  7. Formalize reconciliation procedures of OM&S inventory held by third-party custodians.
  8. Update APSRs to reflect the results of the quarterly reconciliations provided by third-party custodians.

## **B. Valuation for OM&S**

**Condition:** The Marine Corps' OM&S valuation as of September 30, 2017 is not in accordance with GAAP. The Marine Corps did not value current-year OM&S activity in accordance with SFFAS No. 3, and the Marine Corps' valuation of opening balances of OM&S using alternative valuation methods available in accordance with SFFAS No. 48 remains in process as of the FY-end.

The Marine Corps valued OM&S non-ammunition current-year activity using latest acquisition cost, an alternative valuation method in accordance with SFFAS No. 48. Latest acquisition cost is only appropriate for opening balance valuation and is not consistent with the valuation requirements of SFFAS No. 3 (i.e., first-in, first-out [FIFO]; weighted average; or moving average cost flow assumptions).

Finally, the Marine Corps valued OM&S ammunition current-year activity using latest acquisition cost based on FY 2016 pricing information through June 30, 2017. During Q4, the Marine Corps attempted to re-value FY 2017 production receipts based on pricing information from current-year receiving reports. The re-valuation effort was not provided to us until October 2017 and, therefore, could not be audited in the FY 2017 audit timeline.

**Cause:** With the Marine Corps' election to begin the implementation of SFFAS No. 48 for OM&S valuation in FY 2017, there have not been effective business processes, internal controls, and information systems in place to accurately value OM&S in accordance with SFFAS No. 3. The Marine Corps began to implement SFFAS No. 48 for FY 2017; however, the combination of information systems that cannot produce transaction level data to support OM&S quantities and



ineffective inventory management controls necessary to accurately capture the complete Marine Corps OM&S portfolio prevented full implementation of SFFAS No. 48 in FY 2017.

**Effect:** Kearney cannot conclude that OM&S is fairly stated in accordance with GAAP as of September 30, 2017. The Marine Corps' OM&S as of September 30, 2017 does not reflect historical cost as required by SFFAS No. 3, and the Marine Corps' opening balances for FY 2017 do not reflect historical cost under alternative valuation techniques as allowable under SFFAS No. 48. The OM&S valuation may be materially misstated as presented within the Balance Sheet and associated OM&S expenditures resulting from issuances may be misstated as presented on the Statement of Net Cost.

**Recommendations:** Kearney recommends that the Marine Corps continue implementation efforts of SFFAS No. 48 for the opening balance of FY 2018 associated with OM&S. Additionally, Kearney recommends that the Marine Corps:

1. Work with Program Managers to verify that the deemed cost alternative valuation support is in accordance with SFFAS No. 48. The opening balance valuation determination for OM&S inventory must be clearly traceable to supporting documentation maintained in an OM&S inventory file. The OM&S inventory file should include a valuation worksheet signed by a preparer and certified by the Program Manager.
2. Test the new capability to retrieve ammunition lot data from field-level ammunition APSRs upon completion of the One Network upgrade to OIS-MC.
3. Formalize reconciliation procedures at the lot number and serial number levels between OIS-MC and ammunition custodians.
4. Implement full valuation methodologies consistent with requirements set forth in SFFAS No. 3 (i.e., FIFO, weighted average; or moving average cost flow assumptions).

## **VII. Fund Balance with Treasury Controls (New Condition)**

**Background:** FBWT represents the aggregate amount of funds available at Treasury. FBWT is increased by activities such as receipt of new budget authority (e.g., appropriations), transfers from others, and amounts collected and credited to appropriations. FBWT is reduced by activities such as disbursements made to pay liabilities or purchase assets, goods, and services; cancellation of expired appropriations; transfers to others; and rescissions of appropriation. Federal agencies are required to reconcile FBWT with Treasury.

DoD agencies, military services, and other Federal agencies use a variety of systems to routinely process collections and disbursements on behalf of and against others' obligations and receivables in a process broadly referred to as "cross-disbursing." Disbursing entities, including the Marine Corps, report collections and disbursements to Treasury. Statements of Differences (SoD) arise when amounts reported to Treasury differ from actual disbursements and collections due to timing differences, clerical errors, and unreported transactions. In addition, when transactions cannot be identified to a specific appropriation or reporting entity at the end of a reporting period, these transactions are placed into the disbursing entity's associated suspense account for research and resolution.

A third-party service provider is responsible for reconciling Marine Corps FBWT and performs monthly reconciliations between recorded amounts and those reported at Treasury for non-shared appropriations, as well as appropriations shared with the U.S. Navy.

**Condition:** The combination of internal control deficiencies surrounding the Marine Corps' accounting for FBWT represent a material weakness. Kearney noted the following concerns related to existence and completeness of collections and disbursements and related changes to FBWT:

- Non-Marine Corps agencies are able to process collections or disbursements on the Marine Corps' behalf even though such transactions are not able to be immediately matched to valid obligations or receivables in SABRS
- The Marine Corps' financial statements include unsupported transactions that do not match to valid obligations or receivables in SABRS. Although amounts are recorded in summary for financial statement presentation, underlying transaction-level amounts are not recorded in the SABRS GL
- The Marine Corps has not designed or implemented internal control activities to help ensure all collections and disbursements (including those processed by other agencies) are accurate and pertain to the Marine Corps.

In addition, the Marine Corps has not implemented internal control activities to help ensure:

- Proper allocation of summarized cross-disbursement amounts citing appropriations shared with the U.S. Navy
- Proper allocation of adjustments to agree recorded amounts to amounts reported at Treasury for appropriations shared with the U.S. Navy
- Adjustments to agree recorded amounts to amounts reported at Treasury for non-shared appropriations are properly supported and pertain to the Marine Corps
- Completeness of the Marine Corps' financial statements with respect to non-Marine Corps disbursing entities' SoDs that may pertain to the Marine Corps
- Completeness of the Marine Corps' financial statements with respect to other agencies' suspense account amounts that may pertain to the Marine Corps. This is compounded by the underlying business process which assigns suspense transactions to the entity that disbursed the funds rather than the applicable reporting entity.

Although the Marine Corps' third-party service provider attempted to allocate amounts in DON suspense accounts between the Marine Corps and DON for inclusion in the corresponding entities' suspense account adjustments, we identified incorrect allocations of transactions.

The agencies that disburse on behalf of the Marine Corps remit summary-level information to the Marine Corps' third-party service provider for inclusion in the Marine Corps' financial statements. Subsequently, these agencies provide the third-party service provider with the individual transaction-level detail to support cross-disbursements previously reported in summary. However, the Marine Corps does not obtain data descriptive enough to allow its third-party service provider to reconcile individual detailed cross-disbursement transactions to the



originally registered in summary amounts. Oftentimes, these data are not obtained on a timely basis.

**Cause:** The Marine Corps has not designed all necessary internal control activities in its policies and procedures, including full consideration of CUECs, to address risks to its FBWT. In addition, the Marine Corps has not performed a comprehensive analysis of cross-disbursements to identify non-Marine Corps entities that have a higher likelihood of recording the Marine Corps' transactions in suspense accounts or having SoDs that pertain to the Marine Corps. Accordingly, the Marine Corps has not expanded its processes to include monitoring of SoDs and suspense activity for all entities that process collections and disbursements on its behalf. In addition, the Marine Corps has not implemented effective internal control activities to ensure accurate and complete allocation of suspense account transactions that pertain to the Marine Corps. The Marine Corps has not sufficiently coordinated with offices that disburse on its behalf to obtain detailed cross-disbursement records in the accounting period in which they were processed.

**Effect:** The Marine Corps' FBWT may not be accurate, complete, and fairly presented. Specifically:

- Through March 31, 2017, \$409 million (net) of collections and disbursements were initially undistributed or unmatched in SABRS. Of this \$409 million, \$19.2 million remained unresolved in SABRS as of March 31, 2017. As of September 30, 2017, approximately \$76 million was unresolved in SABRS
- The Marine Corps is unable to determine if SoDs for non-Marine Corps entities and balances or portions of balances within other agencies' suspense accounts represent unrecorded transactions in the Marine Corps' accounting records. Kearney also noted SoDs as of March 31, 2017, totaling more than \$2 billion, including more than \$1.1 billion of transactions aged more than 60 days. SoDs represent the risk of unreported transactions and generally cannot be immediately identified to a particular reporting entity, including to what extent differences pertain to the Marine Corps. Of 30 suspense account transactions we tested, 11 transactions were incorrectly excluded from the Marine Corps' financial statements as of March 31, 2017
- The Marine Corps recorded net disbursements and collections of \$212 million in summary, but only recorded \$168 million in detail as of March 31, 2017. Therefore, the Marine Corps lacks assurance that these summary transactions registered in DCAS and included in its financial statements pertain to the Marine Corps and are properly supported
- Recording collections and disbursements in summary amounts represents noncompliance with the FFMIA and prevents proper reconciliation
- The Marine Corps has an increased risk of Antideficiency Act (ADA) violations because its system allows disbursements without first matching to an authorized obligation and because SABRS does not contain a complete record of collections and disbursements at the document level. This also represents noncompliance with FFMIA.

**Recommendations:** Kearney recommends that the Marine Corps:

1. Perform comprehensive risk assessments of cross-disbursements to identify disbursing offices that have a higher risk of including Marine Corps transactions in SoDs or suspense accounts and work towards timely resolution.
2. Examine supporting documentation underlying adjustments to agree recorded amounts to amounts reported at Treasury to ensure transactions pertain to the Marine Corps.
3. Develop and implement internal control activities to ensure suspense transactions are accurately allocated to the appropriate reporting entity.
4. Analyze CUECs and implement internal control activities, including reconciliation of disbursing systems to amounts recorded in SABRS. As necessary, for transactions processed by others, amend SLAs or MOAs.
5. Coordinate with the OUSD(C) to develop or update SOPs, reporting timelines, and required data elements to be provided by disbursing offices for cross-disbursements.

### **VIII. Business Process Controls (New Condition)**

**Background:** The Marine Corps executes daily transactions at the Command-level across the enterprise for a variety of business processes. Business process controls allow the Marine Corps to obtain the goods, services, and personnel it needs to achieve its mission and help ensure transactions are recorded timely, accurately, and completely in SABRS and the various source systems that feed SABRS in accordance with GAAP.

**Condition:** The Marine Corps did not provide sufficient documentation to evidence the operating effectiveness of key controls related to military payroll, including controls related to:

- Certification and authorization of entitlement changes
- Join/triennial audits of Marine records
- Approval of leave requests
- Approval of Reservists' timekeeping
- Certification of dependency documentation needed to support certain entitlements.

In addition, the Marine Corps has control deficiencies specifically related to operating effectiveness of certification controls over civilian timekeeping and authorization controls for individuals in positions to approve personnel actions.

The Marine Corps also has control deficiencies with respect to its budgetary accounting, including those controls related to monitoring obligations, recovering prior-year obligations, approving adjustments to obligations, and authorizing individuals responsible for approving transactions. Specifically:

- Marine Corps Commands independently monitor their own transactions; however, we noted that Daily Transaction Reports (DTR) are not utilized by individual Commands consistently, Commands do not monitor transactions at the same frequency, and Commands do not consistently annotate or evidence their validation efforts on the DTRs

- Amounts recovered from multi-year and no-year funds are immediately made available for new obligations in SABRS without consideration if they have been sufficiently re-apportioned by OMB. Moreover, there are instances in which administrative reclassifications of obligations are accounted for as recoveries of unpaid prior-year obligations and new obligations incurred, even though no such accounting events have occurred
- The Marine Corps places Military Standard Requisition and Issue Procedures (MILSTRIP) supply orders using systems including GCSS-MC and Defense Medical Logistics Standard Support (DMLSS). DMLSS automatically obligates price adjustments in SABRS without Marine Corps approval. GCSS-MC registers price changes without Marine Corps approval, but does not automatically record an adjustment in SABRS, leading to “negative unliquidated obligations” when liquidating the obligation
- The Marine Corps’ documentation related to new obligations did not always denote the authorizing official approving the obligation and whether he/she was authorized to bind the Marine Corps. Similarly, the Marine Corps’ documentation was insufficient to evidence certification controls over outlays.

The Marine Corps is recording liquidations for intragovernmental services prior to the recognition of the corresponding expenses. Expenses are being recorded based on the posting of liquidations from reimbursements to other agencies, rather than the actual receipt and acceptance of goods and services. In addition, the Marine Corps’ non-payroll expenses and AP included instances in which:

- Certain invoices were recorded multiple times
- Expenses for goods or services were incurred in a prior period and not recorded timely
- Receipt and acceptance of goods and services was not documented
- Insufficient funds were obligated prior to the disbursement of Marine Corps funds
- Sufficient documentation was not provided to evidence the control over certification authority.

The Marine Corps established a variety of processes for transportation-related business events, including processes for troop and related cargo movements, as well as Household Goods shipments for Marines’ Permanent Changes of Station. However, these processes do not have adequate transaction-level controls that support timely, accurate, and sufficiently supported recording of accounting entries.

The Marine Corps has opportunities to improve the design of its internal control activities for evidencing receipt and acceptance activities for commercial Transportation of Things, documenting reconciliations of ServMart supply transactions, and standardizing the MILSTRIP fuel requisitions process, as well as safeguarding fuel keys.

For revenue and AR, the Marine Corps did not always:

- Establish interservice support agreements before accepting reimbursable work orders or recognize spending authority from offsetting collections with an authorized funding document
- Record earned revenue and collections in the correct accounting period or make correct adjusting entries related to revenue
- Liquidate AR upon collecting payments.

**Cause:** An overall weak control environment, as evidenced by insufficiently designed and implemented policies and procedures, including insufficient receipt and acceptance requirements, caused these control deficiencies. Moreover, the Marine Corps' management delegates discretion at the Command level in defining, maintaining, implementing, and evidencing key control activities; therefore, certain Commands may not be implementing control activities consistently. Certain SABRS posting logic is incorrect, resulting in accounting errors and inconsistencies. Other factors contributing to the control deficiencies include system interface issues, business processes involving reclassifications of transactions that improperly trigger inaccurate accounting entries, insufficient MOUs with other agencies, and deficient system controls.

**Effect:** The material weakness related to business process controls gave rise to an increased risk of, and in some cases, actual misstatements in the Marine Corps' financial statements.

By not expensing transactions in SABRS upon the receipt and acceptance of goods and services, the Marine Corps may understate both expenses and AP in the period incurred and overstate the accounts in subsequent periods. To correct the abnormal AP balance caused by both intragovernmental and non-intragovernmental liquidations posting prior to expenses, the Marine Corps uses a non-standard business process and records more than 2,000 monthly "Liquidation Greater Than Expenses" (LGTE) JVs in SABRS without individual verification that the expenses are valid. The LGTE JV for September 30, 2016 and 2017 was approximately \$655 million and approximately \$795 million, respectively. The automated LGTE JV process increases the risk that liquidations recorded as expenses may not actually represent expenses.

Other examples of identified misstatements include approximately:

- \$124 million of the Marine Corps' Unpaid obligations brought forward did not represent valid unpaid obligations as of October 1, 2016
- \$60 million of the Marine Corps' Unpaid obligations brought forward consisted of more than 500 "negative unliquidated obligations," which represent untimely and/or incorrectly recorded obligation amounts or erroneously applied payment amounts
- \$65 million of the Marine Corps' recorded Recoveries of unpaid prior-year obligations were not true recoveries; rather, they were the result of the incorrect use of certain GL accounts to record administrative reclassifications of obligated amounts
- \$16 million of the Marine Corps' recorded expenses were for expenses incurred in a prior period and outside of the Marine Corps' estimated accrual window, and \$2.5 million



were for expenses incurred in a prior period and were for business processes not covered by the estimated accrual

- \$1.5 million of the Marine Corps' recorded expenses were duplicated.

Certain matters reported in this section represent noncompliance with the USSGL. In addition, certain findings impede management's ability to exercise control over budgetary resources and increase the risk of the Marine Corps violating the ADA.

**Recommendations:** Kearney recommends that the Marine Corps:

1. Evaluate internal control deficiencies and determine the underlying causes of controls that are not operating effectively. For deficiencies in the design of internal control activities, evaluate Marine Corps policies and procedures to determine whether the design of existing controls should be updated or whether new controls should be developed and implemented.
2. Provide training on any updates to policies and procedures and updated or newly designed controls.
3. Record correcting entries for identified misstatements, assess the underlying cause of the misstatement, and implement corrective actions to address underlying causes (e.g., update SABRS accounting posting logic to avoid the recording of recoveries when administrative funding movements and error corrections are processed).

In addition, Kearney provides the following recommendations specific to individual business processes:

4. Update policies and procedures to prescribe the proper performance and documentation of monitoring/validation procedures for all transactions reported on DTRs and provide training to Fund Managers and Resource Managers on the proper performance and annotation of validation efforts.
5. Modify the posting logic in SABRS to record recoveries of authority in unexpired funds to USSGL Account 445000, *Unapportioned Authority*.
6. Develop and implement policies and procedures to ensure budget authority recovered in unexpired TASs are re-apportioned prior to allotting funds and recording new obligations.
7. Review and develop MOUs with all applicable service providers, such that open orders affected by price adjustments must be re-authorized, adjusted, or cancelled by the Marine Corps prior to delivery or liquidation.
8. Develop system controls to prohibit liquidations in excess of approved obligations within the MILSTRIP supply systems.
9. Analyze the root cause of negative unliquidated obligations and establish and implement internal controls to prevent liquidations from exceeding obligations for individual orders.
10. Conduct a complete review of all aged open orders and de-obligate all orders that no longer are valid and will not require future payment.
11. Perform a detailed analysis to identify specific processes giving rise to the LGTE JVs



and the root causes that necessitate these JVs that are recorded without individual verification that the expenses are valid. Based on the LGTE JV analysis, the Marine Corps should develop procedures to align the recording of expenses and payables with the receipt and acceptance of goods and services, rather than the recording of liquidations in SABRS.

12. Ensure that, for all non-payroll expense business processes, expenses are recorded in the proper period as they are incurred and that receipt and acceptance documentation is completed in a timely manner, including for troop movements, and retained by the Marine Corps to validate the expense.
13. Develop a reconciliation process to ensure the charges being incurred on behalf of the Marine Corps by others are accurate and complete and that charges pertain to the Marine Corps.
14. Assign agreement managers responsibility for administering authorized support agreements and develop a mechanism to help ensure agreement managers are involved with the acceptance of reimbursable work orders.

## **IX. Information Systems (New Condition)**

**Background:** The Marine Corps operates in a complex information system environment to execute its mission and record transactions timely and accurately. In addition to its core accounting system, SABRS, the Marine Corps' information system environment consists of several Tier 1, Tier 2, Tier 3, and third-party systems that have an impact on the Marine Corps' business processes and financial statements. The Marine Corps defines Tier 1 systems as systems that interface (i.e., feed) into SABRS. Tier 2 systems are those that feed Tier 1 systems, and Tier 3 systems feed the Tier 2 systems. Third-party systems are systems that organizations other than the Marine Corps own and operate but still affect the agency's business processes and financial statements.

Because of the sensitive nature of the Marine Corps' information system environment, Kearney does not present specific details related to the systems, conditions, or criteria discussed within this material weakness. We provide those details separately to Marine Corps management and relevant stakeholders through Notifications of Findings and Recommendations (NFR).

**Condition:** The Marine Corps has several deficiencies in the design and operating effectiveness of internal controls related to the core accounting system and key tier and third-party systems. While no single control deficiency meets the level of a material weakness, in combination, these deficiencies elevate to a material weakness due to the pervasiveness of the weaknesses throughout the information system environment and the Marine Corps' reliance on these systems for financial reporting. Our testing disclosed deficiencies in the following areas:

- Security Management
  - Inconsistent implementation of risk assessment policies and procedures for key financial management applications, databases, and operating systems
  - Unavailable or outdated system security plans/security plans and authorities to operate for key financial management systems, databases, and/or operating systems

- Incomplete, inconsistent, or not fully implemented policies and procedures for monitoring third-party service providers
- Inconsistent implementation of policies and procedures for ensuring complete and update-to-date POA&Ms
- Undocumented, incomplete, or not fully implemented policies and procedures for incident response for key financial management systems
- Inconsistently defined frequency of periodic review and update of cybersecurity policies and procedures
- Access controls and segregation of duties
  - Incomplete or not fully implemented policies and procedures for managing and monitoring access to key financial management applications, databases, and operating systems, including third-party systems
  - Incomplete or not fully implemented policies and procedures for the proper segregation of duties within applications, databases, and operating systems
  - Inconsistent implementation of user account recertification to verify the propriety of access
  - Inconsistent logging and monitoring of activity for all key financial management systems
- Configuration management
  - Incomplete and inaccurately documented baseline configuration inventory of hardware, software, and firmware
  - Incomplete, inconsistent, or unmaintained requirements and documentation of configuration changes for certain systems
  - Incomplete listings of system changes and supporting documentation for system changes
- Continuity planning
  - No offsite storage of backups for key financial management systems
  - Incomplete, outdated, unimplemented, and untested continuity planning and disaster recovery policies and procedures for key financial management systems
- Interfaces
  - Inaccurate, incomplete, or unimplemented policies and procedures for monitoring and reconciling interfaces for key financial management systems
  - Incomplete and unimplemented controls to prevent processing of duplicate interface files for the core financial management system.

**Cause:** The deficiencies are a result of multiple circumstances, including the Marine Corps' failure to maintain a robust internal control assessment process that covers the entire information system environment, an incomplete understanding of the information system environment, inconsistent policies and procedures across the multiple Commands, and decentralized Commands responsible for various systems without consistent oversight or processes.

**Effect:** Without robust controls throughout the information system environment, the risk of unauthorized access and information system changes increases, thereby increasing the risk to the systems and the data availability, integrity, and confidentiality.



**Recommendations:** In addition to the related recommendations provided in Section I, *Entity-Level Controls*, Section II, *Ability to Provide Complete, Timely, and Sufficient Evidence*, and Section IV, *Integrated Financial Management Systems*, Kearney recommends that the Marine Corps:

1. Continue to transition all of the Marine Corps' systems to the NIST RMF, which provides a process that integrates security and risk management activities into the system development life cycle.
2. Update policies, procedures, and manuals to include organization, mission/business process, and information system roles and responsibilities for RMF activities.
3. Assess information system risk at the organization and mission/business process tiers, in addition to the current assessments at the information system tier, in accordance with NIST SP 800-30, including consideration of service providers/external entities.
4. Implement security controls to address information system risks using the risk assessments and the Marine Corps' risk tolerance in accordance with NIST.
5. Continue to develop, update, and implement policies, procedures, and manuals to comply with NIST SP 800-53.

\* \* \* \* \*

## **INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS, REGULATIONS, CONTRACTS, AND GRANT AGREEMENTS**

To the Commandant of the United States Marine Corps and Inspector General of the Department of Defense

We were engaged to audit, in accordance with the auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*, the consolidated financial statements of the United States Marine Corps (Marine Corps) as of and for the year ended September 30, 2017, and we have issued our report thereon dated November 9, 2017. Our report disclaims an opinion on such financial statements because we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. The Marine Corps also asserted to departures from generally accepted accounting principles.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Marine Corps' consolidated financial statements are free from material misstatement, we performed tests of its compliance with provisions of applicable laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material impact on the financial statement amounts and disclosures, as well as provisions referred to in Section 803(a) of the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to these provisions and did not test compliance with all laws, regulations, contracts, and grant agreements applicable to the Marine Corps. Providing an opinion on compliance with those provisions was not an objective of our audit; accordingly, we do not express such an opinion. The results of our tests, exclusive of those referred to in the FFMIA, disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 17-03 and are described in the accompanying Schedule of Findings.

The results of our tests of compliance with FFMIA disclosed that the Marine Corps' financial management systems did not comply substantially with the Federal financial management system's requirements, applicable Federal accounting standards, or application of the United States Standard General Ledger (USSGL) at the transaction level, as described in the accompanying Schedule of Findings.

Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the consolidated financial statements, other instances of noncompliance or other matters may have been identified and reported herein.



### **Marine Corps' Response to Findings**

The Marine Corps' response to the findings identified in our engagement is described in a separate memorandum attached to this report. The Marine Corps' response was not subjected to the auditing procedures applied in our engagement to audit the consolidated financial statements; accordingly, we do not express an opinion on it.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's compliance. This report, along with the Independent Auditor's Report and the Independent Auditor's Report on Internal Control over Financial Reporting, is an integral part of an engagement to perform an audit in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and OMB Bulletin No. 17-03 in considering the entity's compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in blue ink that reads "Kearney &amp; Company". The signature is stylized and cursive.

Alexandria, Virginia  
November 9, 2017



## Schedule of Findings

### Noncompliance/Other Matters

#### **I. The Federal Managers' Financial Integrity Act of 1982 (FMFIA) (New Condition)**

The Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, implements the requirements of the Federal Managers' Financial Integrity Act of 1982 (FMFIA). FMFIA and OMB Circular A-123 require agencies to establish a process to document, assess, and assert to the effectiveness of internal control over financial reporting.

The United States Marine Corps (Marine Corps) has not established and implemented controls in accordance with standards prescribed by the Comptroller General of the United States as codified in the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* (the Green Book), as evidenced by the material weakness in the Report on Internal Control.

As discussed in Section I, *Entity-Level Controls*, of the Report on Internal Control, the audit identified the following instances of noncompliance with FMFIA and OMB Circular A-123:

- The Marine Corps has not fully implemented processes to evaluate its entity-level internal controls. Specifically, it did not document and assess its control environment, financial reporting objectives, financial reporting risk assessments, centrally designed internal control activities, internal control directives, and monitoring procedures to ensure internal controls remain effective over time
- The Marine Corps is in the process of implementing a Risk Management Framework for its information system environment on a system-by-system basis. The Marine Corps has not fully implemented comprehensive risk management for the information technology (IT) control environment. This includes an incomplete multi-tier risk management approach to consider risks at the organization, business process, and information system levels. The Marine Corps assesses risk on a system-by-system basis, but it does not assess system risk for the IT control environment at the organization and business process levels, including consideration of non-Marine Corps systems that may affect financial reporting and operations.

#### **II. The Federal Information Security Modernization Act of 2014 (FISMA) (New Condition)**

The Federal Information Security Modernization Act of 2014 (FISMA) requires agencies to provide information security controls commensurate with the risk and potential harm of not having those controls in place. The National Institute of Standards and Technology (NIST) publishes standards and guidelines for Federal entities to implement for non-national security systems. Deviations from NIST standards and guidelines represent departures from FISMA requirements. During our audit, we noted several deviations from NIST standards and guidelines

that contributed to an overall material weakness related to information systems, as described in Section IX, *Information Systems*, in our Report on Internal Control. These deviations represent the Marine Corps' noncompliance with FISMA. As noted in its Assurance Statement, the Marine Corps disclosed an instance of noncompliance with FISMA that is required to be reported under *Government Auditing Standards* and OMB Bulletin No. 17-03. By not complying with FISMA, the Marine Corps' security controls may adversely affect the confidentiality, integrity, and availability of information and information systems. See Section IX, *Information Systems*, of the Report on Internal Control, for additional details.

### **III. The Federal Financial Management Improvement Act of 1996 (FFMIA) (New Condition)**

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires that an entity's overall financial management systems environment operate, process, and report data in a meaningful manner to support business decisions. Compliance with FFMIA is achieved through substantial compliance with the following three Section 803(a) requirements:

- Federal financial management system requirements
- Applicable Federal accounting standards
- United States Standard General Ledger (USSGL) at the transaction level.

The Marine Corps' financial management systems do not substantially comply with the relevant provisions of FFMIA, as asserted to by management, and as discussed below.

#### ***Federal Financial Management Systems Requirements***

FFMIA requires financial management systems owners to implement and monitor Federal information system security controls to minimize the impact to the confidentiality, integrity, and availability of the systems and data. The primary means for Federal entities to provide these controls is the implementation and monitoring of controls defined in NIST Special Publication (SP) 800-53, *Recommended Security Controls for Federal Information Systems*. During our audit of the Marine Corps, we noted several deviations from recommended controls included in NIST SP 800-53, as discussed in Section IX, *Information Systems*, in our Report on Internal Control. These deviations related to security management, access controls, segregation of duties, configuration management, contingency planning, and interfaces, which represent instances of non-compliance with information security requirements.

### ***Federal Accounting Standards***

FFMIA requires that agency management systems maintain data to support reporting in accordance with accounting principles generally accepted in the United States of America (GAAP). As identified through our audit procedures and as noted by the Marine Corps in Note 1, *Significant Accounting Policies*, the Marine Corps disclosed several instances where it departed from GAAP. The Marine Corps asserted to the following departures from GAAP:

- Accrual accounting requirements per Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*, and SFFAS No. 5, *Accounting for Liabilities of the Federal Government*
- Recognition and valuation requirements set forth in SFFAS No. 3, *Accounting for Inventory and Related Property*
- The full cost provisions of SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, as amended by SFFAS No. 30, *Inter-Entity Cost Implementation*, and the reporting requirements associated with presenting the Statement of Net Cost by major program
- Contingent legal liability requirements set forth in SFFAS No. 5 and SFFAS No. 12, *Recognition of Contingent Liabilities Arising from Litigation*
- Recognition and valuation requirements set forth in SFFAS No. 6, *Accounting for Property, Plant, and Equipment*
- Revenue recognition requirements set forth in SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*
- Accounting and reporting requirements associated with restatements per SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, and OMB Circular A-136, *Financial Reporting Requirements*
- Reporting and valuation requirements set forth in SFFAS No. 29, *Heritage Assets and Stewardship Land*, and disclosure requirements in SFFAS No. 42, *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards No. 6, No. 14, No. 29, and No. 32*.

In addition, the Marine Corps did not fully comply with the financial reporting requirements prescribed by OMB Circular A-136, as discussed in our Report on Internal Control, Section III, *Financial Reporting and Analysis*, and as disclosed by the Marine Corps in Note 1, *Significant Accounting Principles*.

### ***USSGL at the Transaction Level***

FFMIA requires that agency management systems record financial events by applying the USSGL guidance in the Treasury Financial Manual at the transaction level. The Marine Corps' financial management systems do not always record financial events in accordance with the requirements of the USSGL at the transaction level. During our audit, we identified the following instances of noncompliance with the USSGL:

- The Marine Corps’ core accounting system, as currently implemented, is not fully compliant with USSGL. Specifically, the core accounting system does not:
  - Accumulate or transmit complete and accurate attribute data to support financial reporting requirements
  - Currently accomplish year-end closing of period accounts and the system tables developed to support system closing are not fully used, nor routinely reviewed for USSGL compliance
  - Possess General Ledger Account Numbers which match standard USSGL accounts correctly in all instances and require a crosswalk for reporting
- Property, Plant, and Equipment (PP&E) and Operating Materials and Supplies (OM&S) capital expenditures were recorded as operating expenses within the core accounting system. The Marine Corps was unable to separately identify capitalized expenses from non-capital expenses to appropriately account for expenditures in accordance with SFFAS No. 6 and SFFAS No. 3. For additional details, see Section IV.D, *Integration between Accountable Property Systems of Record and Standard Accounting, Budget, and Reporting System (SABRS)*, in our Report on Internal Control
- The Marine Corps was unable to provide OM&S data for certain asset classes or the OM&S data available from the Marine Corps’ systems did not provide sufficient information to demonstrate the existence, completeness, and valuation of the reported balances. See further detail in Section VI, *Accounting for Operating Materials and Supplies*, of our Report on Internal Control
- The Marine Corps did not produce accounts payable and receivable listings by vendor and debtor, respectively, nor did it produce a listing of obligations incurred, as discussed in Section II, *Ability to Provide Complete, Timely, and Sufficient Evidence*, of our Report on Internal Control
- The Marine Corps’ financial statements included summarized amounts that could not be supported at the transaction level for:
  - Collections and disbursements that were processed by non-Marine Corps disbursing offices
  - Civilian payroll unfunded accrued leave liability, which could not be specifically identified at the employee level
  - Recorded accounts payable related to cancelled appropriations were not readily available at the transaction level or reviewed to confirm validity
- The Marine Corps’ financial statements included amounts that did not distribute to specific organizational components or match to specific obligations or receivables in the core accounting system.

\* \* \* \* \*

# RESPONSE TO INDEPENDENT AUDITORS' REPORT



DEPARTMENT OF THE NAVY  
HEADQUARTERS UNITED STATES MARINE CORPS  
3000 MARINE CORPS PENTAGON  
WASHINGTON, DC 20350-3000

IN REPLY REFER TO  
7500  
ADC P&R  
8 Nov 17

From: Fiscal Director of the Marine Corps  
To: Engagement Partner, Kearney and Company, P.C.

Subj: MANAGEMENT COMMENTS TO THE INDEPENDENT AUDITOR'S REPORT  
ON THE UNITED STATES MARINE CORPS FULL FINANCIAL  
STATEMENT AUDIT FOR FISCAL YEAR 2017 (CONTRACT NO. GS-  
00F-031DA)

1. Unless otherwise noted, the Marine Corps concurs with the Independent Auditor's Report on the United States Marine Corps Full Financial Statement Audit (FFS) for Fiscal Year (FY) 2017 and the Reports on Internal Control and Compliance with Laws and Regulations.

2. The Marine Corps acknowledges the material weaknesses identified in the Report on Internal Control. We will continue to focus on efforts that implement risk management methodologies, modernize financial management systems, evaluate internal controls at the entity level, and improve the accuracy of financial reporting. In some cases, we have already begun causative research and discussed the corrective actions required to resolve financial reporting deficiencies. We are assessing end-to-end business processes to identify key controls, evaluating the design and effectiveness of key controls currently in place, and determining where additional controls are needed. We remain committed to strengthening internal controls by implementing the process improvements needed to ensure the operational, financial, and systems control environment is well documented and understood by the Marine Corps at large.

3. Although the FY2017 audit resulted in a Disclaimer of Opinion, the Marine Corps believes that through the audit we have gained valuable insights about what is needed to meet audit requirements. Our staff of dedicated Marine civilians, military, and contractors successfully delivered approximately 2,360 PBCs, 6,700 samples, and over 3,800 answers to follow-up questions to Kearney and Company, P.C. We assisted the auditors in conducting 13 site visits and made discoveries about the operational environment that otherwise may not have been known.



Subj: MANAGEMENT COMMENTS TO THE INDEPENDENT AUDITOR'S REPORT  
ON THE UNITED STATES MARINE CORPS FULL FINANCIAL  
STATEMENT AUDIT FOR FISCAL YEAR 2017 (CONTRACT NO. GS-  
00F-031DA)

Our answers to auditor requests for information were not always timely, but we completed the audit. With an awareness of the level of effort required, we intend to position the Marine Corps for future success.

4. The Marine Corps has a commitment to the American taxpayer to be good stewards of the resources entrusted to us to support combat readiness and the warfighter. We recognize that standard business processes, reliable IT systems and effective management internal controls are key to honoring these commitments. We look forward to working with Kearney and Company, P.C. and other interested parties in future financial statements audits.

  
C. E. SPANGLER

Copy to:  
ASN (FM&C)  
ACMC  
DMCS  
DC P&R  
ADC R



## PRINCIPAL FINANCIAL STATEMENTS

The United States Marine Corps (USMC) consolidated and combined financial statements have been prepared to report the financial position, results of operations, net position, and budgetary resources pursuant to the requirements of the *Chief Financial Officers (CFO) Act of 1990 (P.L. 101-576)*, as amended by the *Government Management Reform Act (GMRA) of 1994 (P.L. 103-356)*, and Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*, as amended. The statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) as outlined by the Federal Accounting Standards Advisory Board (FASAB), unless otherwise noted.

The responsibility for the integrity of the financial information included in these statements rests with USMC management. Kearney & Company, P.C. (Kearney) was the independent public accountant engaged to audit USMC's principal financial statements. The Independent Auditor's Report accompanies the principal financial statements.

**UNITED STATES MARINE CORPS**
**CONSOLIDATED BALANCE SHEETS**

As of September 30, 2017 and 2016

(\$ in thousands)

	Unaudited 2017	Unaudited 2016
<b>ASSETS (Note 2)</b>		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 9,420,817	\$ 9,127,607
Accounts Receivable (Note 5)	38,985	48,449
Total Intragovernmental Assets	<u>9,459,802</u>	<u>9,176,056</u>
Cash and Other Monetary Assets (Note 7)	5,219	4,609
Accounts Receivable, Net (Note 5)	13,532	12,577
Inventory and Related Property, Net (Note 9)	10,959,693	12,246,278
General Property, Plant and Equipment, Net (Note 10)	16,786,957	17,976,898
Other Assets (Note 6)	81,035	84,450
<b>TOTAL ASSETS</b>	<u>\$ 37,306,238</u>	<u>\$ 39,500,868</u>
<b>STEWARDSHIP PROPERTY, PLANT &amp; EQUIPMENT (Note 10)</b>		
<b>LIABILITIES (Note 11)</b>		
Intragovernmental:		
Accounts Payable (Note 12)	\$ 198,568	\$ 171,484
Other Liabilities (Note 15 & 16)	66,842	73,186
Total Intragovernmental Liabilities	<u>265,410</u>	<u>244,670</u>
Accounts Payable (Note 12)	634,511	902,400
Military Retirement and Other Federal Employment Benefits (Note 17)	186,041	182,508
Environmental and Disposal Liabilities (Note 14)	212,064	189,204
Other Liabilities (Note 15 and Note 16)	992,356	1,016,172
<b>TOTAL LIABILITIES</b>	<u>\$ 2,290,382</u>	<u>\$ 2,534,954</u>
<b>COMMITMENTS AND CONTINGENCIES (NOTE 16)</b>		
<b>NET POSITION</b>		
Unexpended Appropriations - Other Funds	\$ 8,292,587	\$ 8,048,558
Cumulative Results of Operations - Dedicated Collections (Note 23)	1,212	1,229
Cumulative Results of Operations - Other Funds	<u>26,722,057</u>	<u>28,916,127</u>
<b>TOTAL NET POSITION</b>	<u>35,015,856</u>	<u>36,965,914</u>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<u>\$ 37,306,238</u>	<u>\$ 39,500,868</u>

The accompanying notes are an integral part of these statements.

**UNITED STATES MARINE CORPS**
**CONSOLIDATED STATEMENTS OF NET COST**

For the Periods Ended September 30, 2017 and 2016

(\$ in thousands)

	Unaudited 2017	Unaudited 2016
<b>Program Costs</b>		
Military Personnel	\$ 13,495,068	\$ 13,452,275
Operations, Readiness & Support	7,116,644	8,480,948
Procurement	2,356,243	1,679,054
Research, Development, Test & Evaluation	655,927	602,251
Gross Costs	23,623,882	24,214,528
(Less: Earned Revenue)	(399,085)	(265,602)
Net Cost before Losses/(Gains) from Actuarial Assumption		
Changes for Military Retirement Benefits	\$ 23,224,797	\$ 23,948,926
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	-	-
Net Program Costs Including Assumption Changes	23,224,797	23,948,926
Costs Not Assigned to Programs	-	-
(Less: Earned Revenues) Not Attributed to Programs	-	-
<b>Net Cost of Operations</b>	<u>\$ 23,224,797</u>	<u>\$ 23,948,926</u>

The accompanying notes are an integral part of these statements.

**UNITED STATES MARINE CORPS**
**CONSOLIDATED STATEMENTS OF CHANGES IN NET POSITION**

For the Periods Ended September 30, 2017 and 2016

(\$ in thousands)

	Unaudited 2017	Unaudited 2016
<b>CUMULATIVE RESULTS OF OPERATIONS</b>		
<b>Beginning Balances</b>	\$ 28,917,356	\$ 29,910,342
<b>Prior Period Adjustments:</b>		
Changes in accounting principles (+/-)	-	(1,855,470)
<b>Beginning balances, as adjusted (Includes Funds from Dedicated Collections - See Note 23)</b>	28,917,356	28,054,872
<b>Budgetary Financing Sources:</b>		
Other adjustments (+/-)	(827)	-
Appropriations used	23,314,043	23,992,457
Nonexchange revenue	124	123
Transfers-in/out without reimbursement	(27)	23,000
<b>Other Financing Sources:</b>		
Transfers-in/out without reimbursement (+/-)	138,203	5,079
Imputed financing from costs absorbed by others	62,555	76,256
Other (+/-)	(2,483,361)	714,495
<b>Total Financing Sources (Includes Funds from Dedicated Collections - See Note 23)</b>	21,030,710	24,811,410
<b>Net Cost of Operations (+/-) (Includes Funds from Dedicated Collections - See Note 23)</b>	23,224,797	23,948,926
<b>Net Change</b>	(2,194,087)	862,484
<b>Cumulative Results of Operations (Includes Funds from Dedicated Collections - See Note 23)</b>	26,723,269	28,917,356
<b>UNEXPENDED APPROPRIATIONS</b>		
<b>Beginning Balances (Includes Funds from Dedicated Collections - See Note 23)</b>	8,048,558	9,568,658
<b>Beginning balances, as adjusted</b>	8,048,558	9,568,658
<b>Budgetary Financing Sources:</b>		
Appropriations received	24,134,310	23,196,543
Appropriations transferred-in/out	(13,918)	28,150
Other adjustments (+/-)	(562,320)	(752,336)
Appropriations used	(23,314,043)	(23,992,457)
<b>Total Budgetary Financing Sources (Includes Funds from Dedicated Collections - See Note 23)</b>	244,029	(1,520,100)
<b>Unexpended Appropriations (Includes Funds from Dedicated Collections - See Note 23)</b>	8,292,587	8,048,558
<b>Net Position</b>	\$ <u>35,015,856</u>	\$ <u>36,965,914</u>

The accompanying notes are an integral part of these statements.



**UNITED STATES MARINE CORPS**
**COMBINED STATEMENTS OF BUDGETARY RESOURCES**

For the Periods Ended September 30, 2017 and 2016

(\$ in thousands)

	Unaudited 2017	Unaudited 2016
<b>Budgetary Resources:</b>		
Unobligated balance brought forward, Oct 1	\$ 1,852,994	\$ 1,920,990
Unobligated balance brought forward, Oct 1, as adjusted	1,852,994	1,920,990
Recoveries of unpaid prior year obligations	800,106	1,005,845
Other changes in unobligated balance (+ or -)	(559,961)	(520,131)
Unobligated balance from prior year budget authority, net	2,093,139	2,406,704
Appropriations (discretionary and mandatory)	24,120,488	23,016,623
Spending Authority from offsetting collections (discretionary and mandatory)	445,829	277,479
Total Budgetary Resources	<u>\$ 26,659,456</u>	<u>\$ 25,700,806</u>
<b>Status of Budgetary Resources:</b>		
New obligations and upward adjustments (total)	\$ 24,726,163	\$ 23,847,812
Unobligated balance, end of year:		
Apportioned, unexpired accounts	707,390	484,432
Unexpired unobligated balance, end of year	707,390	484,432
Expired unobligated balance, end of year	1,225,903	1,368,562
Unobligated balance, end of year (total)	<u>1,933,293</u>	<u>1,852,994</u>
Total Budgetary Resources	<u>\$ 26,659,456</u>	<u>\$ 25,700,806</u>
<b>Change in Obligated Balance:</b>		
<b>Unpaid obligations:</b>		
Unpaid obligations, brought forward, Oct 1	\$ 7,268,589	\$ 8,748,579
New obligations and upward adjustments	24,726,163	23,847,812
Outlays (gross) (-)	(23,695,057)	(24,321,957)
Recoveries of prior year unpaid obligations (-)	(800,106)	(1,005,845)
Unpaid obligations, end of year	7,499,589	7,268,589
<b>Uncollected payments:</b>		
Uncollected pymts, Fed sources, brought forward, Oct 1 (-)	(80,639)	(100,840)
Change in uncollected pymts, Fed sources (+ or -)	(3,495)	20,201
Uncollected pymts, Fed sources, end of year (-)	(84,134)	(80,639)
<b>Memorandum Entries:</b>		
Obligated balance, start of year (+ or -)	<u>\$ 7,187,950</u>	<u>\$ 8,647,739</u>
Obligated balance, end of year (+ or -)	<u>\$ 7,415,455</u>	<u>\$ 7,187,950</u>
<b>Budget Authority and Outlays, Net:</b>		
Budget authority, gross (discretionary and mandatory)	\$ 24,566,317	\$ 23,294,102
Actual offsetting collections (discretionary and mandatory) (-)	(445,519)	(298,692)
Change in uncollected payments, Federal Sources (discretionary and mandatory) (+ or -)	(3,495)	20,201
Recoveries of prior year paid obligations (discretionary and mandatory)	3,185	1,012
Budget Authority, net (total) (discretionary and mandatory)	<u>\$ 24,120,488</u>	<u>\$ 23,016,623</u>
Outlays, gross (discretionary and mandatory)	\$ 23,695,057	\$ 24,321,957
Actual offsetting collections (discretionary and mandatory) (-)	(445,519)	(298,692)
Outlays, net (total) (discretionary and mandatory)	23,249,538	24,023,265
Distributed offsetting receipts (-)	6,467	(2,951)
Agency Outlays, net (discretionary and mandatory)	<u>\$ 23,256,005</u>	<u>\$ 24,020,314</u>

The accompanying notes are an integral part of these statements.

# NOTES TO PRINCIPAL FINANCIAL STATEMENTS

## NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

### 1.A. Basis of Presentation

These consolidated and combined financial statements have been prepared to report the financial position, and results of operations of the USMC as required by the CFO Act of 1990, as amended by the GMRA of 1994, and OMB Circular No. A-136, as amended.

Though USMC produces financial statements as a stand-alone entity, USMC remains a component of the U.S. Department of the Navy (DON). These financial statements have been prepared from the books and records of USMC in accordance with U.S. GAAP, promulgated by the FASAB, except as described in Note 1.D, *Basis of Accounting*. The accompanying financial statements account for all resources for which the USMC is responsible, excluding USMC working capital fund (WCF) activities and account balances. The USMC WCF is separately consolidated into the DON WCF financial statements and footnote disclosures.

The USMC's Statement of Net Cost (SNC) is presented by major appropriation instead of by major programs aligned to USMC strategic goals as required by OMB Circular No. A-136.

### 1.B. Mission of the Reporting Entity

USMC is a component reporting entity of the DON that prepares general purpose federal financial reports. USMC financial data ultimately gets consolidated into the financial statements and footnotes of the DON. USMC does not have any sub-components but consolidates allocation transfer activity into its financial statements and footnotes.

USMC receives support from other U.S. Department of Defense (DoD) entities to execute its operations as a military service. For example, buildings and facilities on USMC installations are constructed by DON's Naval Facilities Engineering Command (NAVFAC) because DON receives the military construction funding; USMC uses DON aircraft, the maintenance and repair for which are performed by the DON's Naval Air Systems Command (NAVAIR); and, similar to other DoD agencies, USMC's healthcare services are provided by the Defense Health Agency (DHA).

USMC also relies on third party service providers, primarily Defense Accounting and Finance Service (DFAS) for accounting services, Defense Logistics

Agency (DLA) for procurement services, and Defense Information Systems Agency for information technology goods and services.

USMC reports a GAAP departure in its reporting entity definition at Note 1.D, *Basis of Accounting*.

### 1.C. Appropriations and Funds

To support its core mission, the USMC is funded through both direct appropriations and appropriations shared with the DON. USMC receives General Fund appropriations to include active duty military and reserve personnel; operations and maintenance; procurement; and research, development, test, and evaluation (RDT&E). USMC, as a designated reporting entity within the DoD, maintains accountability for its budgetary resources.

USMC also reports special and deposit funds. Special funds accounts are used to record government receipts reserved for a specific purpose. Certain special funds may be designated as funds from dedicated collections. Funds from dedicated collections are financed by specially identified revenues, required by statute to be used for designated activities, benefits or purposes and remain available over time (see Note 23, *Funds from Dedicated Collections*). Deposit funds are used to record amounts held temporarily until paid to the appropriate government or public entity. They are not available for USMC's operations. Rather, USMC is acting as an agent or a custodian for funds awaiting distribution.

USMC is a party to allocation transfers with other Federal agencies as a transferring (parent) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. Generally, all financial activity related to these allocation transfers (e.g. budget authority, obligations, outlays) are reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations and budget apportionments are derived. USMC allocates

funds, as the parent, to the Department of Transportation (DOT), Federal Highway Administration.

### 1.D. Basis of Accounting

USMC records transactions on the accrual and budgetary bases of accounting, unless otherwise indicated below as departures from U.S. GAAP. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred without regard to receipt or payment of cash. The accrual method also includes information about costs arising from the consumption of assets and the incurrence of liabilities. The budgetary accounting principles are designed to recognize the obligation of funds according to legal requirements, which in many cases is prior to the occurrence of an accrual-based transaction. Budgetary accounting is used for planning and control purposes and relates to both the receipt and use of cash, as well as reporting federal deficits. The recognition of budgetary accounting transactions is essential for compliance with legal constraints and controls over the use of federal funds.

Throughout these financial statements, assets, liabilities, earned revenue, and costs have been classified according to the type of entity with which the transactions were made. Intragovernmental assets and liabilities represent the claims of one federal entity against another. Intragovernmental earned revenue represents collections or accruals of revenue from other federal entities. Intragovernmental costs are payments or accruals of cost for goods and services provided by other federal entities. Public costs and revenues are exchange transactions made between the reporting entity and a non-federal entity.

Non-entity assets are not available for the use in the USMC's normal operations. USMC has stewardship accountability and reporting responsibility for non-entity assets. Non-entity assets are classified as non-entity Fund Balance with Treasury (FBWT), which includes tax withholdings or garnishments; non-entity cash and other monetary assets maintained by the various USMC disbursing officers; and non-entity public accounts receivable, which represents interest, fines, and penalties. See Note 2, *Nonentity Assets*.

Application of Accounting Estimates. The financial statements are based on the selection of accounting policies and the application of significant accounting estimates, some of which require management to make significant assumptions. Further, the estimates are based on current conditions that may change in the future. Actual results could differ from the estimated amounts.

Estimates are made for items such as payroll accruals, accounts payable, environmental liabilities, accounts receivable's allowance for doubtful accounts, contingent liabilities, and depreciation expense.

Departures from U.S. GAAP. Financial management systems and operations continue to be refined as USMC strives to record and report its financial activity in accordance with U.S. GAAP. Currently, USMC has identified the following departures from GAAP, a number of which are pervasive problems within DoD that all military services face and cannot be remediated at the USMC level:

*Operating Material and Supplies.* USMC's Accountable Property Systems of Record (APSRs) are not currently configured to support Operating Materials and Supplies (OM&S) operations in accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 3, *Accounting for Inventory and Related Property*. This condition applies to all relevant OM&S subsets and business processes, to include set assemblies, temporary storage projects, consumables and repairables, and ammunition. Specifically, USMC is working to (1) consistently apply the consumption method to its accounting of OM&S; and (2) fully implement valuation processes that comply with SFFAS No. 3. In addition to APSR concerns, USMC is also working to: (1) request Defense Departmental Reporting System (DDRS) modifications to present the "Held for Future Use" category of OM&S in Note 9, *Inventory and Related Property*; (2) identify and properly record excess, obsolete, and unserviceable (EOU) OM&S; (3) conduct extensive wall-to-wall inventory counts of its OM&S; (4) rectify existing reconciliation issues between USMC and Army to account for the USMC ordnance in Army custody; and (5) record long lead time materials as work-in-progress ammunition projects. OM&S beginning balances have not been established and USMC management has not yet made its unreserved assertion in accordance with SFFAS No. 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*.

*Imputed Costs.* USMC systems and processes do not capture the full cost of goods and services provided by other DoD and federal entities on USMC's behalf where the costs are not reimbursable, in accordance with SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards*, as amended by SFFAS No. 30, *Inter-Entity Cost Implementation*. For example, the DON provides aviation support to the USMC in coordination with ongoing operations and training missions. USMC

does not record aviation assets on the balance sheet or impute the costs incurred by the DON on USMC's behalf. Another example is healthcare services provided to USMC by DHA. In most of these instances, cost accumulation data is not available or provided to the USMC to record the imputed financing.

*General Property, Plant, and Equipment.* USMC has efforts ongoing to address difficulties in determining the completeness and accuracy of reported balances and providing support for all asset costs. Among the areas in which USMC is committed to improve include (1) the recurring performance of wall-to-wall inventory counts; (2) the recurring performance of impairment assessments; (3) identification of the full universe of its internal use software (IUS) in development costs; (4) accounting for General Equipment (GE) Construction in Progress (CIP) properly at the transaction level; and (5) identification of the full scope of government furnished property provided to contractors. Supportable General Property, Plant, and Equipment (GPP&E) beginning balances have not been established and USMC management has not yet made its unreserved assertion in accordance with SFFAS No. 50, *Establishing Opening Balances for General Property, Plant, and Equipment*. In addition, USMC does not yet have a SFFAS No. 6, *Accounting for Property, Plant and Equipment* compliant process to value new GPP&E.

*Accounts Payable.* The accounts payable balance and associated accounts payable accruals reported at period end are not in full compliance with SFFAS No. 1, *Accounting for Selected Assets and Liabilities* and SFFAS No. 5, *Accounting for Liabilities of the Federal Government*. Receipt and acceptance of goods and services provided to USMC are not recorded or reported timely. Expenses and accounts payable are not recorded until liquidation/disbursement, resulting in understated delivered orders-unpaid and abnormal accounts payable balances driven by liquidations exceeding expenses.

*Leases.* USMC has not completed a review and analysis of its universe of assets and corresponding lease information to properly account for capital and operating leases, and to identify property where the USMC is the lessor. Accordingly, USMC is not compliant with SFFAS No. 5 and SFFAS No. 6. In addition, USMC is not compliant with the presentation of lease information in the footnotes as required by OMB Circular No. A-136.

*Environmental Liabilities.* USMC does not report environmental liabilities for relevant GE in accordance with SFFAS No. 5, SFFAS No. 6, and Federal Financial Accounting and Auditing Technical Release No. 2,

*Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government* as detailed disposal cost data is neither readily available nor provided by DoD entities responsible for asset disposal. The environmental liabilities currently reported by USMC is limited to clean-up cost estimates related to real property and general equipment attached to real property. In addition, the U.S. Navy centrally manages and executes the Defense Environmental Restoration Program (DERP) and Base Realignment and Closure (BRAC) portions of the environmental liability at the DON level. Therefore, USMC does not report DERP and BRAC environmental liabilities.

*Definition of Reporting Entity.* USMC's current reporting entity definition excludes certain funds at the instruction of the DoD and the DON to include other funding provided to DoD Agencies that benefit the USMC. In addition, USMC financial statements exclude financial activity associated with appropriations 17X1001, Medicare-Eligible Retiree Health Fund Contribution, Marine Corps, and 17X1003, Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Marine Corps, at the instruction of the DON. The DON has elected to record and report activity related to these two appropriations on its financial statements.

*Correction of Errors from Previous Accounting Periods.* Ongoing corrective action and remediation activities related to GPP&E and OM&S conducted by USMC identified accounting errors related to prior periods during FY 2017 of approximately \$1.2 billion (net) dollars. The DON, DFAS – Agency Wide, and DFAS-Cleveland did not concur with USMC's decision to restate FY 2016 financial statements. Therefore, USMC elected to use the current year gain/loss accounts as opposed to prior period adjustment accounts that would have required restatement of prior financial statements. By not restating the prior year financial statements, USMC acknowledges that it is not in compliance with SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*.

*Other Assets.* Note 6, *Other Assets*, contains a line item for Outstanding Contract Financing Payments. However, these Outstanding Contract Financing Payments are contract progress payments that should be recorded as GPP&E CIP in accordance with SFFAS No. 6. Therefore, Outstanding Contract Financing Payments currently recorded as Other Assets are misclassified and should be recorded as GPP&E CIP in Note 10, *General Property, Plant, and Equipment, Net*.



*Legal Liabilities and Contingencies.* DoD's automated system processes have limited capability to capture contractual contingent liabilities. Therefore, the contingent amounts related to contract arrangements for USMC is not disclosed in Note 15, *Other Liabilities*. In addition, USMC does not analyze the merits of outstanding cases individually to derive its applicable legal contingent liabilities and disclosures in accordance with SFFAS No. 5 and SFFAS No. 12, *Recognition of Contingent Liabilities Arising from Litigation*.

*Statement of Net Cost.* Costs for major programs are not presented on the statement of net cost as required by the Government Performance and Results Act.

*Presentation and Disclosure.* USMC is not in compliance with OMB Circular No. A-136 because the following required footnotes and disclosures are not prepared due to a lack of readily available data and/or a process to compile them:

- *Cost of Stewardship PP&E;*
- *Stewardship PP&E through Transfer, Donation or Devise;*
- *Exchange Revenue; and*
- *Explanation of Differences between the Statement of Budgetary Resources (SBR) and the Budget of the U.S. Government.*

USMC is also not in compliance with OMB Circular No. A-136 for all required disclosures within Management's Discussion and Analysis; Required Supplementary Information; Required Supplementary Stewardship Information; and Other Information.

## **1.E. Revenues and Other Financing Sources**

USMC receives the majority of the funding needed to perform its mission through appropriations. These appropriations may be used, within statutory limits, for operating and capital expenditures. In addition to appropriations, other financing sources include exchange and non-exchange revenues. USMC classifies revenues as either exchange (earned) or non-exchange. Exchange revenues are those that derive from transactions in which the Government provides value to the public or another Government entity at a price. Non-exchange revenues derive from the Government's sovereign right to demand payment, including fines and penalties. These revenues are not considered to reduce the cost of USMC's operations and are reported on the Consolidated Statements of Changes in Net Position (SCNP).

USMC receives revenue from a number of sources, including commercial vendors conducting business at USMC installations (e.g. a restaurant paying rent); utility payments and recycling service fees; payments from other military services and executive branch agencies, such as the State Department, who are operating out of USMC installations; royalties from licensing and trademarking agreements with external parties; and out leases for agricultural activities taking place on USMC installations. Other federal and non-federal entities pay USMC based on the specific terms of the agreements that govern the use of USMC facilities, often reimbursable agreements.

Program costs of USMC paid out of the funds appropriated to other federal agencies, such as costs of retirement programs paid by the Office of Personnel Management (OPM) and certain legal judgments against USMC paid from the Judgment Fund maintained by the Department of the Treasury, are recorded as imputed financing sources.

## **1.F. Recognition of Expenses**

Current financial and non-financial feeder systems were not designed to collect and record financial information on the full accrual accounting basis. In some instances, expenditures for capital and other long-term assets are initially recognized as operating expenses (such is the case for OM&S) due to system and/or business process limitations, but are adjusted to be recorded in the asset account at period end. See Note 1.D, *Basis of Accounting* for related GAAP departures.

## **1.G. Accounting for Intragovernmental Activities**

In accordance with Section 7 of the Department of Treasury's Federal Intragovernmental Transactions Accounting Policies Guide, USMC accounts for all intragovernmental transactions at the transaction level. In an effort to more efficiently identify intragovernmental transactions by customer, USMC has implemented the DoD's trading partner requirements in its accounting system to capture trading partner data. Generally, seller entities within DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances and are then eliminated at the DON and/or DoD reporting level. The DoD is implementing replacement systems and a standard financial information structure that will incorporate the necessary elements to enable DoD to correctly report, reconcile, and eliminate intragovernmental balances. USMC incorporated intragovernmental purchases into an accrual process that



recognizes intragovernmental work performed but not invoiced by the seller. See Note 12, *Accounts Payable*, for further detail.

## **1.H. Transactions with Foreign Governments and International Organizations**

Each year, USMC sells defense articles and services to foreign governments and international organizations under the provisions of the Arms Export Control Act of 1976. Under the provisions of the Act, DoD has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. Payment in U.S. dollars is required in advance.

### **1.I. Funds with the U.S. Treasury**

FBWT is maintained in U.S. Treasury accounts and is available to pay current liabilities and finance authorized purchases. FBWT is increased by the receipt of budgetary resources (appropriations and collections) and decreased by outlays and funds transfers. FBWT does not include fiduciary assets or funds, but does include general, special and deposit funds. The disbursing offices of DFAS, the military services, the U.S. Army Corps of Engineers, and the State Department's financial service centers process the majority of USMC cash collections, disbursements, and adjustments worldwide. On a monthly basis, USMC's FBWT is reviewed and adjusted, as required, to agree with the U.S. Treasury FBWT accounts.

FBWT includes amounts for revenue and expense transactions that are recorded in suspense accounts, which include accounts and appropriations shared with the DON, as a result of missing or mismatched lines of accounting or other discrepancies. These transactions are researched and reclassified pending disposition from the responsible financial managers. See Note 3, *Fund Balance with Treasury*.

### **1.J. Cash and Other Monetary Assets**

Cash and other monetary assets consist of cash held by disbursing officers located at all USMC installations and forward operating areas. Cash is classified as non-entity and is restricted. See Note 7, *Cash and Other Monetary Assets*.

### **1.K. Accounts Receivable**

Accounts receivable from other federal entities or the public include: accounts receivable, claims receivable, and refunds receivable, net of the allowance for estimated uncollectible amounts. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience. The USMC does not recognize

an allowance for estimated uncollectible amounts from other federal agencies (intragovernmental receivables) as receivables from other federal agencies are considered to be inherently collectible. Claims on intragovernmental receivables are resolved between the agencies in accordance with the Intragovernmental Business Rules published in the Treasury Financial Manual. See Note 5, *Accounts Receivable*.

### **1.L. Direct Loans and Loan Guarantees**

USMC does not have Direct Loans and Loan Guarantees.

### **1.M. Inventories and Related Property**

The USMC does not hold inventory for resale; rather, USMC has related property known as OM&S.

USMC discloses OM&S based upon the type and condition of the asset. OM&S Held for Use consists of items that are consumed during the normal course of USMC operations. OM&S Held for Future Use consists of items not normally used in the course of USMC operations but have more than a remote chance of being needed in the future. OM&S Held for Repair consists of damaged material on hand that is more economical to repair than to dispose. EOU OM&S consists of scrap material or items that cannot be economically repaired and are awaiting disposal. The USMC recognizes EOU OM&S at a net realizable value of zero.

USMC is establishing beginning balances using latest acquisition cost (LAC) in conformance with SFFAS 48; however, beginning balances have not yet been asserted as disclosed in the GAAP departures in 1.D, *Basis of Accounting*, above. See Note 9, *Inventory and Related Property*.

### **1.N. Investments in U.S. Treasury Securities**

USMC does not have investments in U.S. Treasury securities.

### **1.O. General Property, Plant and Equipment**

USMC has valued its GPP&E using the "deemed cost" methodologies per SFFAS No. 50. However, systems required to account for USMC GPP&E at historical cost on a go-forward basis in accordance with SFFAS No. 6 are not yet fully in place. Therefore, USMC is not making an unreserved assertion as discussed in SFFAS No. 50 with respect to this balance sheet line item, and reported a GAAP departure at Note 1.D, *Basis of Accounting*.

In accordance with SFFAS No. 6, when an asset has a useful life of two or more years and when the deemed cost equals or exceeds USMC's capitalization threshold, GPP&E assets are capitalized. USMC

capitalizes improvements to existing GPP&E assets if the improvements equal or exceed the capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. USMC depreciates all GPP&E, other than land, on a straight-line basis.

Real property, which constitutes a majority of the GPP&E line item balance, has a capitalization threshold of \$250 thousand; as does IUS. In accordance with SFFAS No. 50, USMC elected to use deflated plant replacement value (D-PRV) to value real property assets and establish beginning balances; however, as noted, beginning real property balances have not been asserted in accordance with the standard. D-PRV is based on cost factors such as averages of contractual cost data from the prior three years, commercially available cost data, and models using general price information. D-PRV is inclusive of capital improvements.

The DON accumulates and reports real property CIP on the DON's consolidated financial statements. The DON receives Military Construction funds and executes these funds to further the mission of the DON consolidated entity. When a building or other structure is complete, the DON transfers the finished product to USMC, at which point USMC will record the asset and report it on the USMC financial statements. USMC is responsible for sustainment, utilization, and operational control until the asset is disposed.

USMC did not have any IUS recorded on the balance sheet as of September 30, 2016 due to the prospective capitalization of IUS in accordance with SFFAS No. 50. Other than real property, GPP&E includes GE which has a capitalization threshold is \$100 thousand.

GE consists of all personal property intended to be used by the USMC to carry out battlefield missions, and used by installations, bases, and stations to carry out non-battlefield essential functions. By definition, GE: (1) does not ordinarily lose its identity or become a component part of another article and is available for the use of the reporting entity for its intended purpose, (2) has intangible assets included in the cost of the related equipment, and (3) are generally functionally-complete assets that should be valued based on the cost of the final assembly, including the cost of embedded items. GE does not include aircraft, with the exception of unmanned aircraft. Aircraft are recorded and reported by the DON on its financial statements.

In fiscal years 2017 and 2016, the GE CIP balance was estimated based on the total contract line item expenditures for capital equipment assets in development

net of progress payments made and end items received and accepted as reported by the Mechanization of Contract Administration Services (MOCAS) system on behalf of the USMC.

The USMC has elected to apply the provisions of SFFAS No. 50, paragraph 13, to land and land rights. For purposes of financial reporting, USMC has fully expensed all existing land and land rights and disclosed total acres of land owned per the requirements of SFFAS No. 50.

USMC maintains Stewardship PP&E that reflects its rich history and aims to preserve assets and property of historical significance. USMC has the responsibility for the maintenance and accountability of heritage assets, and stewardship land. USMC's reporting of Stewardship PP&E is not fully GAAP compliant as noted in section 1.D, *Basis of Accounting* of this footnote, above. See Note 10, *General Property, Plant, and Equipment, Net*.

### **1.P. Advances and Prepayments**

USMC payments made in advance of the receipt of goods and services are recorded as advances and prepayments at the time of prepayment and recognized as expenditures/operating expenses when the related goods and services are received. USMC makes advanced payments to Marines for advanced pay and permanent changes of station, and to pay vendors in some circumstances. USMC records these advances as an asset on the balance sheet as non-federal other assets. Public entities with which the USMC does business are required to provide advance payment for goods and services, and for rent and lease payments for usage of space on USMC installations and facilities. See Note 6, *Other Assets*.

### **1.Q. Leases**

USMC acknowledges a departure from GAAP related to the accounting and reporting of capital and operating leases as noted in section 1.D, *Basis of Accounting*, of this footnote, above.

### **1.R. Other Assets**

Non-federal other assets with the public consists of real property permanently removed from service but not yet disposed in accordance with FASAB Technical Release 14, *Implementation Guidance on the Accounting and Disposal of General Property, Plant, & Equipment*. See Note 6, *Other Assets*.

### **1.S. Contingencies and Other Liabilities**

SFFAS No. 5, as amended by SFFAS No. 12, defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible

gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The USMC recognizes contingent liabilities when past events occur, a future loss is probable, and the loss amount can be reasonably estimated. Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses.

USMC's contingent liabilities may arise from pending or threatened litigation or claims and assessments due to events such as aircraft, ship and vehicle accidents; property or environmental damage; contractual bid protests; and equal opportunity matters. USMC's current systems do not have the capability to capture accurate amounts for contingent liabilities related to contracts and has documented this as a departure from GAAP in Section 1.D, *Basis of Accounting*, of this footnote. See Note 16, *Commitments and Contingencies*.

Other liabilities also arise as a result of anticipated disposal costs for USMC's assets. Based on DoD's policy, which is consistent with SFFAS No. 5, non-environmental disposal liabilities are recognized when management decides to dispose of an asset. These amounts are not easily distinguishable and are identified in conjunction with environmental disposal costs. As noted above in GAAP departures at 1.D, *Basis of Accounting*, the USMC does not report environmental liabilities and associated costs for the disposal of its weapons systems. See Note 14, *Environmental and Disposal Liabilities*.

### **1.T. Accrued Leave**

USMC reports accrued unfunded liabilities for military leave and annual leave for civilians. Leave is accrued as it is earned and reduced when it is taken. Annual leave is accrued each pay period based on an employee's time of service. Per the federal leave policy established by the OPM, full-time employees with less than three years of service accrue four hours of annual leave each pay period; full-time employees with at least three years of service but less than 15 years of service accrue six hours of annual leave each pay period; and full-time employees with more than 15 years of service or more accrue eight hours of annual leave each pay period. The liabilities are recorded based on current pay rates. While employees accrue sick leave each pay period, sick leave for civilians is expensed as taken. See Note 15, *Other Liabilities*.

### **1.U. Net Position**

Net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations are represented by the total of undelivered orders and unobligated balances. Cumulative results of operations represent the net of revenues, expenses, other financing sources, gains, and losses since inception.

### **1.V. Treaties for Use of Foreign Bases**

USMC conducts operations overseas and in coordination with foreign governments in accordance with Status of Force Agreements.

### **1.W. Undistributed Disbursements and Collections**

Refer to the suspense account discussion within section 1.I, *Funds with the U.S. Treasury*, of this footnote, above.

### **1.X. Fiduciary Activities**

USMC performs certain fiduciary activities, including the Thrift Savings Program and Savings Deposit Program, on behalf of non-federal entities. Fiduciary assets are not recognized as USMC assets and are not reported on the balance sheet. See Note 24, *Fiduciary Activities*.

### **1.Y. Military Retirement and Other Federal Employment Benefits**

For financial reporting purposes, the Department of Labor (DOL) develops the actuarial liability for workers' compensation benefits under the requirements of the Federal Employees' Compensation Act (FECA) and provides it to the USMC at the end of each fiscal year.

Military retirement is accounted for in the audited financial statements of the Military Retirement Fund; as such, the USMC does not record any liabilities or obligations for pensions or healthcare retirement benefits.

Health benefits are funded centrally at the DoD level. As such, the portion of the health benefits actuarial liability that is applicable to USMC is reported only on the DoD agency-wide financial statements and the Medicare-Eligible Retiree Health Care Fund financial statements. See Note 17, *Military Retirement and Other Federal Employment Benefits*.

### **1.Z. Significant Events**

USMC does not have any significant events to disclose.

## NOTE 2. NONENTITY ASSETS

As of September 30 (Amounts in thousands)	Unaudited 2017	Unaudited 2016
<b>Intragovernmental Assets</b>		
Fund Balance with Treasury	\$ 37,411	\$ 45,414
Accounts Receivable	-	-
Other Assets	-	-
Total Intragovernmental Assets	\$ 37,411	\$ 45,414
<b>Nonfederal Assets</b>		
Cash and Other Monetary Assets	\$ 5,219	\$ 4,609
Accounts Receivable	101	104
Other Assets	-	-
Total Nonfederal Assets	\$ 5,320	\$ 4,713
<b>Total Nonentity Assets</b>	\$ 42,731	\$ 50,127
<b>Total Entity Assets</b>	\$ 37,263,507	\$ 39,450,741
<b>Total Assets</b>	\$ 37,306,238	\$ 39,500,868

Non-entity FBWT represents amounts in USMC deposit fund accounts. The deposit fund accounts contain various withholdings from Marines' pay, such as taxes, allotments, and garnishments held until the appropriate disbursement date.

Non-entity cash and other monetary assets represent U.S. Department of the Treasury (Treasury) funding provided to and held by USMC disbursing officers, to cover operational needs of all U.S. military branches, including USMC, and other federal agencies.

The non-entity non-federal accounts receivable represents interest, fines, and penalties receivable on aged delinquent debts. Once collected, non-entity receivables are deposited in the U.S. Treasury as miscellaneous receipts.

## NOTE 3. FUND BALANCE WITH TREASURY

As of September 30 (Amounts in thousands)	Unaudited 2017	Unaudited 2016
<b>Fund Balances</b>		
Appropriated Funds	\$ 9,347,472	\$ 9,039,662
Revolving Funds	-	-
Trust Funds	-	-
Special Funds	1,277	1,283
Other Fund Types	72,068	86,662
Total Fund Balances	\$ 9,420,817	\$ 9,127,607
<b>Fund Balances Per Treasury Versus Agency</b>		
Fund Balance per Treasury	\$ 8,187,290	\$ 7,744,723
Fund Balance per Marine Corps	9,420,817	9,127,607
<b>Reconciling Amount</b>	\$ (1,233,527)	\$ (1,382,884)

Composition of Reconciling Amount between Treasury and USMC (schedule below and accompanying discussion in thousands):

(unaudited)	
Appropriations shared per USMC*	\$ 1,164,923
Parent/Child Transfer**	300
Suspense Accounts per USMC***	72,067
USMC Fiduciary Activity Balance****	(3,763)
Total Reconciling Amount	\$ 1,233,527

\*This amount represents the DON appropriations allocated to the USMC (Research, Development, Test and Evaluation, Navy \$510,762; Navy; Procurement of Ammunition, Navy and Marine Corps \$596,040; Family Housing Operation and Maintenance, Navy and Marine Corps \$46,833, Other Procurement, Navy \$10,011; and Wildlife Conservation, Military Reservations, Navy \$1,277). These allocations are supported by funding authorization documents issued by the DON to USMC.

\*\* This amount represents an allocation transfer to the DOT in a parent/child relationship in which USMC is the parent and DOT is the child. The amount is related to the USMC's funds allocated to the DOT's appropriation, Treasury Index 69-1106.5.

\*\*\* This amount consists of suspense and deposit accounts shared with the U.S. Navy and is comprised of (\$811,300) collections and \$883,367 disbursements. The Department of the Treasury does not separately identify USMC's portions of the shared suspense and deposit accounts with DON. The related suspense and deposit accounts are identified in the "Other fund types" discussion in this footnote, above.

\*\*\*\*USMC fiduciary activities are comprised of the deposit fund, composed of \$73 from the Thrift Savings Plan (TSP), and \$3,690 from the Savings Deposit Program (SDP).

The "special funds" category for USMC represents the Wildlife Conservation, Military Installations fund which generates non-exchange revenue from the sale of fishing and hunting permits. See Note 23, *Funds from Dedicated Collections*.

"Other fund types" primarily consist of deposit funds and suspense accounts that represent receipts held temporarily for distribution to another fund or entity or held as an agent for others. The related deposit accounts include: Small Escrow Amounts Deposit Account, Withhold State and Local Taxes, and Advances without Orders from Non-Federal Sources. The Small Escrow Amounts Deposit Account is used for escrow amounts held less than a year (ex. security deposits related to contract bidding). The related suspense accounts include (1) the Budgetary Clearing Account; (2) the Lost or Cancelled Treasury Checks Suspense Account; and (3) the Interfund/Intragovernmental Payment and Collection (IPAC) Suspense Account.

### Status of Fund Balance with Treasury

As of September 30 (Amounts in thousands)	Unaudited 2017	Unaudited 2016
<b>Unobligated Balance</b>		
Available	\$ 707,391	\$ 484,432
Unavailable	1,225,902	1,368,562
<b>Obligated Balance not yet Disbursed</b>	\$ 7,499,590	\$ 7,268,590
<b>Nonbudgetary FBWT</b>	\$ 72,068	\$ 86,662
<b>NonFBWT Budgetary Accounts</b>	\$ (84,134)	\$ (80,639)
<b>Total</b>	<b>\$ 9,420,817</b>	<b>\$ 9,127,607</b>



The Status of FBWT schedule reflects the budgetary resources available to fund all USMC activities and reconciles budgetary and proprietary accounts. It primarily consists of unobligated balances and obligated balances not yet disbursed.

Unobligated Balance is classified as available or unavailable and represents the cumulative amount of budgetary authority that has not yet been set aside to cover outstanding obligations. Certain unobligated balances are restricted for future use and are not apportioned for current use.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods and services but not yet paid.

Non-budgetary FBWT includes accounts without budgetary authority, such as deposit funds, unavailable receipt accounts, clearing accounts and non-entity FBWT. Non-budgetary FBWT is comprised of the FBWT for the Disbursing Officer Suspense Account, the Lost or Cancelled Treasury Checks Suspense Account, Interfund/IPAC Suspense Account, the Small Escrow Accounts Deposit Account, the Withhold State and Local Taxes account; and the Other Federal Payroll Withholding – Allotments account.

Non-FBWT budgetary accounts reduce the FBWT balance. Non-FBWT budgetary accounts are comprised of unfilled customer orders without advance and reimbursements and other income earned-receivable.

#### NOTE 4. INVESTMENTS AND RELATED INTEREST

USMC does not have investments.

#### NOTE 5. ACCOUNTS RECEIVABLE

As of September 30 (Amounts in thousands)	Unaudited 2017		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
<b>Intragovernmental Receivables</b>	\$ 38,985	-	\$ 38,985
<b>Nonfederal Receivables (From the Public)</b>	\$ 16,136	\$ (2,604)	\$ 13,532
<b>Total Accounts Receivable</b>	<u>\$ 55,121</u>	<u>\$ (2,604)</u>	<u>\$ 52,517</u>

As of September 30 (Amounts in thousands)	Unaudited 2016		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
<b>Intragovernmental Receivables</b>	\$ 48,449	-	\$ 48,449
<b>Nonfederal Receivables (From the Public)</b>	\$ 15,832	\$ (3,255)	\$ 12,577
<b>Total Accounts Receivable</b>	<u>\$ 64,281</u>	<u>\$ (3,255)</u>	<u>\$ 61,026</u>

Accounts receivable represent the USMC's claim for payment from other entities. USMC uses three years of historical accounts receivable data to compute the allowance percentage for the following age categories: 91-180 days, 181-365 days, 1-2 years, 2-6 years, 6-10 years, and more than 10 years. The allowance percentages are then applied to their corresponding balances by age category at year end to calculate the allowance for uncollectible accounts.

## NOTE 6. OTHER ASSETS

As of September 30 (Amounts in thousands)	Unaudited 2017	Unaudited 2016
<b>Intragovernmental Other Assets</b>		
Advances and Prepayments	\$ -	\$ -
Other Assets	-	-
Total Intragovernmental Other Assets	\$ -	\$ -
<b>Nonfederal Other Assets</b>		
Outstanding Contract Financing Payments	\$ 70,246	\$ 73,614
Advances and Prepayments	8,742	10,836
Other Assets (With the Public)	2,047	-
Total Nonfederal Other Assets	\$ 81,035	\$ 84,450
<b>Total Other Assets</b>	<u>\$ 81,035</u>	<u>\$ 84,450</u>

“Nonfederal Other Assets – Outstanding Contract Financing Payments” represent progress payments on MOCAS contracts. As noted in Note 1.D, *Basis of Accounting*, these progress payments are misclassified as other assets; they should have been recorded as GPP&E CIP.

“Nonfederal Other Assets – Advances and Prepayments” represent payments USMC made to servicemen and women in advance, such as for travel, and prepayments to vendors.

## NOTE 7. CASH AND OTHER MONETARY ASSETS

As of September 30 (Amounts in thousands)	Unaudited 2017	Unaudited 2016
<b>Cash</b>	\$ 5,209	\$ 4,568
<b>Foreign Currency</b>	10	41
<b>Other Monetary Assets</b>	-	-
<b>Total Cash, Foreign Currency, &amp; Other Monetary Assets</b>	<u>\$ 5,219</u>	<u>\$ 4,609</u>

Cash and foreign currency are non-entity assets held by USMC. Cash and foreign currency are restricted, held by USMC disbursing officers, but not included in USMC FBWT activity until specifically disbursed or collected on behalf of USMC.

## NOTE 8. DIRECT LOAN AND LOAN GUARANTEES

USMC does not have Direct Loans and Loan Guarantees.

## NOTE 9. INVENTORY AND RELATED PROPERTY

As of September 30 (Amounts in thousands)	Unaudited 2017	Unaudited 2016
Inventory, Net	\$ -	\$ -
Operating Materiel & Supplies, Net	10,959,693	12,246,278
Stockpile Materiel, Net	-	-
<b>Total</b>	<u>\$ 10,959,693</u>	<u>\$ 12,246,278</u>

## Operating Material and Supplies, Net

As of September 30 (Amounts in thousands)	Unaudited 2017			
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
<b>OM&amp;S Categories</b>				
Held for Use	\$ 10,031,725	\$ -	\$ 10,031,725	SP, LAC, MAC
Held for Repair	927,968	-	927,968	SP, LAC, MAC
Excess, Obsolete, and Unserviceable	10,644	(10,644)	-	NRV
<b>Total</b>	<b>\$ 10,970,337</b>	<b>\$ (10,644)</b>	<b>\$ 10,959,693</b>	

As of September 30 (Amounts in thousands)	Unaudited 2016			
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
<b>OM&amp;S Categories</b>				
Held for Use	\$ 11,338,886	\$ -	\$ 11,338,886	SP, LAC, MAC
Held for Repair	907,392	-	907,392	SP, LAC, MAC
Excess, Obsolete, and Unserviceable	9,575	(9,575)	-	NRV
<b>Total</b>	<b>\$ 12,255,853</b>	<b>\$ (9,575)</b>	<b>\$ 12,246,278</b>	

### Legend for Valuation Methods:

LAC = Latest Acquisition Cost

SP = Standard Price

AC = Actual Cost

NRV = Net Realizable Value

LCM = Lower of Cost or Market

FIFO = First-In-First-Out

MAC = Moving Average Cost

### General Composition of Operating Material and Supplies

USMC reports OM&S within two broad categories as conventional ground ammunition and explosives (known as Class V OM&S), and non-ammunition. Ammunition is any device charged with explosives, propellants, and pyrotechnics for use in connection with military operations and structure demolition. Non-ammunition OM&S items may include spare and repair parts, fuel, construction materials, clothing and textiles, and medical and dental supplies. The USMC manages only military or government-specific material.

Ordnance is a term that is used interchangeably with ‘ammunition’. A significant amount of ordnance is held outside of the custody of USMC by the Department of the Army and the DON; however, the USMC maintains the rights to the ordnance and reports the balances on its financial statements. The amounts of ordnance held by the Department of the Army and the DON on USMC’s behalf are \$5.97 billion and \$789 million, respectively.

### Basis of Valuation and Cost Flow Assumptions

USMC is establishing beginning balances using LAC in conformance with SFFAS No. 48; however, beginning balances have not yet been asserted. To sustain beginning balances, USMC intends to utilize the first-in, first-out method in conformance with SFFAS No. 3. USMC’s current logistics and accountable property systems are not capable of supporting the consumption method of accounting. Due to the system limitation, USMC currently utilizes the purchase method at the transaction level to recognize OM&S, which is not compliant with SFFAS No. 3. However, USMC records a journal voucher to report the value of OM&S on hand as of the reporting period end on the balance sheet.

### Restrictions on Operating Material and Supplies

There are no restrictions on the use of OM&S.

### Criteria for Identifying the Category to which Operating Material and Supplies are Assigned

USMC determines reporting categories for OM&S using condition codes assigned to individual inventory items. There are numerous condition codes used by USMC to categorize the status of OM&S as either serviceable, unserviceable, or suspended. The Deputy Commandant, Installations & Logistics for Non-Ammo and Program Manager for Ammunition make OM&S determinations consistently based on a process that considers factors such as item condition, intended use, and estimated time of consumption.

### Correction of Prior Period Accounting Errors

During FY 2017, journal entries were recorded affecting the OM&S balance sheet account resulting from the identification of accounting errors related to prior fiscal years. These adjustments were necessary to record the impact of corrective actions taken and were recorded in current year gains/losses accounts. USMC reported a GAAP departure at Note 1.D, *Basis of Accounting*, for this accounting treatment.

### Excess, Obsolete, Unserviceable Category

EOU OM&S represents scrap materials awaiting disposal which is reduced to a net book value of zero prior to transfer to DLA's Disposition Services. USMC is not paid and does not receive an economic benefit from the return of excess supplies.

### Held for Future Use Category

The current format of the footnote schedule does not incorporate the required category of OM&S, 'Held for Future Use'. USMC currently includes the 'Held for Future Use' amount of OM&S in the 'Held for Use' category. 'Held for Future Use' OM&S is approximately \$282 million as of September 30, 2017.

## **NOTE 10. GENERAL PROPERTY, PLANT AND EQUIPMENT, NET**

As of September 30 (Amounts in thousands)	Unaudited 2017				
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
<b>Major Asset Classes</b>					
Land	N/A	N/A	\$ -	- \$	-
Buildings, Structures, and Facilities	S/L	20 or 40	17,910,799	\$ (6,921,001)	10,989,798
Leasehold Improvements	S/L	lease term	-	-	-
Software	S/L	2-5 or 10	750	-	750
General Equipment	S/L	Various	21,012,953	(15,255,695)	5,757,258
Assets Under Capital Lease	S/L	lease term	-	-	-
Construction-in- Progress	N/A	N/A	39,151	-	39,151
Other			-	-	-
Total General PP&E			\$ 38,963,653	\$ (22,176,696)	\$ 16,786,957

As of September 30 (Amounts in thousands)	Unaudited 2016				
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
<b>Major Asset Classes</b>					
Land	N/A	N/A	\$ -	- \$	-
Buildings, Structures, and Facilities	S/L	20 or 40	19,160,167	\$ (7,743,640)	11,416,527
Leasehold Improvements	S/L	lease term	-	-	-
Software	S/L	2-5 or 10	-	-	-
General Equipment	S/L	Various	20,905,445	(14,520,560)	6,384,885
Assets Under Capital Lease	S/L	lease term	-	-	-
Construction-in- Progress	N/A	N/A	175,486	-	175,486
Other			-	-	-
Total General PP&E			\$ 40,241,098	\$ (22,264,200)	\$ 17,976,898

**Legend for Valuation Methods:**

S/L = Straight Line

N/A = Not Applicable

Land and Land Rights

USMC applied the provisions of SFFAS No. 50, paragraph 13, to land and land rights by fully expensing all existing land and land rights as of September 30, 2017. In compliance with the requirements of SFFAS No. 50, USMC will continue to expense future land and land rights, and provide the total acres held at the beginning of the reporting period, the number of acres purchased or disposed of during the reporting period, and the number of acres held at the end of the reporting period.

**Land as of September 30, 2017**

Unaudited

Beginning Balance	Additions	Change in Acreage	Deletions	Ending Balance
2,638,760.429	14,773.282	(5,479.555)	(223,814.578)	2,424,239.578

Real Property

Real property comprises the majority of USMC's GPP&E balance. In accordance with Title 10 of the United States Code, the construction of buildings, structures and facilities is performed by the DON's NAVFAC. NAVFAC has full command and control over construction operations, but USMC has some limited input in the process when the facilities being constructed are for USMC. USMC recognizes a real property asset when a facility is constructed by NAVFAC and provided to USMC to inhabit and utilize. Therefore, real property CIP is not recognized by USMC as incurred, unless the USMC funds the real property CIP through its Operations and Maintenance appropriations. Title of the real property remains with NAVFAC throughout the life of the asset, but USMC is responsible for those costs needed to repair and maintain the real property. Capital improvement plans are submitted to NAVFAC for approval and NAVFAC ultimately decides when a project will occur based on Department-level requirements. For some locations, the Army Corps of Engineers may construct capital improvements and/or buildings and structures. Such capital improvements are funded with DON's Military Construction appropriation funds. However, the USMC may use Operations and Maintenance funding for buildings, structures, and capital improvements less than \$750,000.



USMC elected to use D-PRV to value real property assets that exist as of September 30, 2017. D-PRV is based on cost factors such as averages of contractual cost data from the prior three years, commercially available cost data, and models using general price information. D-PRV is inclusive of capital improvements. SFFAS No. 50 allows for D-PRV to be used as a starting point in establishing replacement cost, or deemed cost, for real property. OUSD has endorsed non-D-PRV as the deemed cost methodology of choice. However, USMC has employed D-PRV due to concerns regarding the overstatement of assets when using non-D-PRV. Deflation factors used in the calculation of D-PRV are based on the Bureau of Economic Analysis inflation factors published annually, and are an accepted practice to deflate current values back to the fiscal year in which the financial event occurred.

USMC conducted an extensive analysis to identify the placed in service date (PISD) for all capital real property assets. In some cases, the key supporting documentation did not exist to support the PISD, and in compliance with SFFAS No. 50 the PISD was estimated using alternate sources such as cornerstones, plaques, as-built drawings, earliest known asset site plots, maintenance records, or documented similar assets.

#### Internal Use Software

IUS is identified in the schedule, above, as “software” and can be purchased from commercial vendors off-the-shelf, modified “off the shelf,” internally developed, or contractor developed. IUS includes software that is: (1) used to operate an entity’s programs (e.g. financial and administrative software, including that used for project management), (2) used to produce the entity’s goods and to provide services (e.g. maintenance work order management and loan servicing), and (3) developed or obtained for internal use and subsequently provided to other federal entities with or without reimbursement. IUS does not include computer software that is integrated into and necessary to operate GPP&E.

In accordance with SFFAS No. 50, USMC has elected to prospectively report capitalized IUS. In support of this process, the USMC identified all IUS, both fielded and in-development, and excluded these assets from the FY 2017 opening balance. USMC began reporting the historical cost of all new IUS starting October 1, 2016.

IUS In-development. Consistent with SFFAS No. 50 and OUSD Memorandum, *Strategy for Internal Use Software Audit Readiness*, all IUS costs prior to October 1, 2016 were expensed. For FY 2017 and going forward, USMC will maintain data to support transactional activities. Costs associated with software in-development are capitalized as GPP&E.

#### General Equipment

GE consists of all property not classified as real property or land, but GE balances exclude aircraft, which is not recorded by USMC, with the exception of unmanned aircraft. Aircraft are recorded and reported by the DON on its financial statements. The DON’s NAVAIR has responsibility for the construction, repair, maintenance, and disposal of all aircraft.

#### Construction in Progress

Construction costs of capital GE are capitalized as CIP. Upon completion of the project, the costs are transferred to the GE account.

#### Corrections of Prior Period Accounting Errors

During FY 2017, journal entries were recorded affecting the GE (military equipment/garrison mobile equipment) and real property portion of GPP&E resulting from the identification of accounting errors from prior fiscal years. These adjustments were necessary to record the impact of corrective actions taken. These adjustments were recorded in current year gains/losses accounts. USMC reported a GAAP departure at Note 1.D, *Basis of Accounting* for this accounting treatment.

#### Restrictions on the use or convertibility of GPP&E, Net

For USMC sites outside of the continental U.S. there are no restrictions on the use or convertibility of GPP&E. In other areas where Marines are deployed, such as Iraq and Afghanistan, information is not available regarding restrictions on GPP&E.

## Stewardship PP&E

USMC policy focuses on the preservation of its heritage assets, which are items of historical, cultural, educational, or artistic importance. Heritage assets consist of buildings and structures, and museum collections.

### Relationship of Heritage Assets to USMC's Mission

The overall mission of USMC is to provide trained and equipped forces to Combatant Commanders in support of the President's National Security Strategy. In that mission the USMC, with minor exceptions, uses buildings and stewardship land in its daily activities and includes the buildings on the balance sheet as multi-use heritage assets (capitalized and depreciated).

### Buildings and Structures

Buildings and structures listed on or eligible for listing on the National Register of Historic Places, including multi-use heritage assets.

### Archeological Sites

Archeological sites include cemeteries, memorials, and other structures and statues that meet the definition of heritage assets and are reported in this footnote.

### Museum Collection Items

Museum collection items are items that have historical or natural significance; cultural, educational, or artistic importance (including fine art, items such as portraits and artist depictions of historical value); or significant technical or architectural characteristics.

The methodology used to report the condition of the heritage assets is based upon a combination of visual assessment of the objects, historic value to the USMC collection, and consideration of general display and storage standards for historic collections in accordance with USMC, DON, and DoD Policy. Heritage assets are primarily acquired through donations from individuals and organizations. All museum collection items are tracked in the DON Heritage Assets Management System (DONHAMS) and are disclosed, below.

### **Heritage Assets as of September 30, 2017** (Unaudited)

Categories	Measure Quantity	Beginning Balance	Additions	Deletions	Ending Balance
Buildings and Structures	Each	6,531	-	-	6,531
Archeological Sites	Each	5,966	-	-	5,966
Museum Collection Items (Objects, Not Including Fine Art)	Each	59,354	3,321	-	62,675
Museum Collection Items (Objects, Fine Art)	Each	9,937	92	21	10,008

Museum Collection Items are acquired through donation, purchases (rare), and transfer. USMC did not purchase any new assets during the period reported; all additions were the result of donation. Asset withdrawals from the population arise from the USMC deaccession process. This occurs when museum curators in-charge of a given collection develops a written report detailing why the asset is no longer required for the collection. The deaccession report is presented to USMC collections committees and voted on, after which, it is signed off by the Director and the object is processed out. USMC then documents transfer or disposal. The database, DONHAMS, tracks whether an object is accessioned or de-accessioned in order to report appropriate numbers. DONHAMS does not report whether or not an object was donated, purchased, or transferred. Museum staff is ethically bound not to engage in appraisals or assign value to incoming donations. They do, however, make a general assessment of value for the purposes of gift acceptance at the appropriate level.

## Stewardship Land

The USMC's stewardship land consists mainly of mission essential land acquired by donation or devise.

### Stewardship Land as of September 30, 2017

(Unaudited)

Facility Code	Facility Title	Beginning Balance	Additions	Deletions	Ending Balance
<i>(Acres in thousands)</i>					
9110	Government Owned Land	1	-	1	-
9111	State Owned Land	1	-	1	-
9120	Withdrawn Public land	1,481	-	227	1,254
9130	Licensed and Permitted Land	-	-	-	-
9140	Public Land	-	-	-	-
9210	Land Easement	-	-	-	-
9220	In-leased Land	-	-	-	-
9230	Foreign Land	-	-	-	-
Grand Total					1,254
Total – All Other Lands					-
Total – Stewardship Lands					1,254

Some of this land is used as a buffer around the perimeter of USMC installations and may be used as grazing land and forestry maintenance areas. USMC strives to be a responsible steward of the land and maintain it in a way that protects human health and the environment, and allows for training and support of force readiness. Once an installation determines that there is no longer a need for stewardship land, the installation submits a request to have the land removed. If USMC approves of the request, the request is then sent to the DON for execution of the removal of the stewardship land from the record.

## Leases

Refer to GAAP departure disclosure in footnote 1.D, *Basis of Accounting*.

## NOTE 11. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

As of September 30 <i>(Amounts in thousands)</i>	Unaudited 2017	Unaudited 2016
<b>Intragovernmental Liabilities</b>		
Accounts Payable	\$ -	\$ -
Debt	-	-
Other	51,029	58,062
<b>Total Intragovernmental Liabilities</b>	\$ 51,029	\$ 58,062
<b>Nonfederal Liabilities</b>		
Accounts Payable	\$ 6,857	\$ 137,914
Military Retirement and Other Federal Employment Benefits	184,718	181,129
Environmental and Disposal Liabilities	212,064	189,204
Other Liabilities	749,421	782,129
<b>Total Nonfederal Liabilities</b>	\$ 1,153,060	\$ 1,290,376
<b>Total Liabilities Not Covered by Budgetary Resources</b>	\$ 1,204,089	\$ 1,348,438
<b>Total Liabilities Covered by Budgetary Resources</b>	\$ 1,086,293	\$ 1,186,516
<b>Total Liabilities</b>	\$ 2,290,382	\$ 2,534,954

Liabilities not covered by budgetary resources (or unfunded liabilities) are liabilities not covered by realized budgetary resources as of the balance sheet date. Budgetary authority to satisfy these liabilities is expected to be provided in a future Defense Appropriations Act.

The “Intragovernmental Liabilities – Other” line item represents liabilities for workers’ compensation (Federal Employees Compensation Act) and unemployment compensation.

“Nonfederal Liabilities – Accounts Payable” are related to valid claims associated with cancelled appropriations. The significant decrease of \$131 million compared to prior year is attributable to the adjustment made to remove unsupported balances and is documented as a GAAP departure in Note 1.D, *Basis of Accounting*.

“Nonfederal Liabilities – Military Retirement and Other Federal Employment Benefits” consist of employee actuarial liabilities associated with the Federal Employees Compensation Act. Refer to Note 17, *Military Retirement and Other Federal Employment Benefits*, for additional details and disclosures.

“Nonfederal Liabilities – Environmental and Disposal Liabilities” are estimates related to future events that will be budgeted for when those assets are removed from service and cleaned up in future years. Refer to Note 14, *Environmental and Disposal Liabilities*, for additional details and disclosures and Note 1.D, *Basis of Accounting* for GAAP departure.

“Nonfederal Liabilities – Other Liabilities” includes civilian and military unfunded leave and legal contingent liabilities. Unfunded military and civilian leave liability is funded as annual leave is taken.

## NOTE 12. ACCOUNTS PAYABLE

As of September 30 (Amounts in thousands)	Unaudited 2017		
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
Intragovernmental Payables	\$ 198,568	\$ -	\$ 198,568
Nonfederal Payables (to the Public)	634,511	-	634,511
<b>Total</b>	<b>\$ 833,079</b>	<b>\$ -</b>	<b>\$ 833,079</b>

As of September 30 (Amounts in thousands)	Unaudited 2016		
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
Intragovernmental Payables	\$ 171,484	\$ -	\$ 171,484
Nonfederal Payables (to the Public)	902,400	-	902,400
<b>Total</b>	<b>\$ 1,073,884</b>	<b>\$ -</b>	<b>\$ 1,073,884</b>

Refer to Note 1.D, *Basis of Accounting* for accounts payable GAAP departures.

## NOTE 13. DEBT

USMC does not have debt.

## NOTE 14. ENVIRONMENTAL AND DISPOSAL LIABILITIES

As of September 30 (Amounts in thousands)	Unaudited 2017	Unaudited 2016
<b>Environmental Liabilities--Nonfederal</b>		
Accrued Environmental Restoration Liabilities		
Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	\$ -	\$ -
Active Installations—Military Munitions Response Program (MMRP)	-	-
Formerly Used Defense Sites—IRP and BD/DR	-	-
Formerly Used Defense Sites--MMRP	-	-
Other Accrued Environmental Liabilities—Non-BRAC		
Environmental Corrective Action	108	106
Environmental Closure Requirements	130,211	124,367
Environmental Response at Operational Ranges	-	-
Asbestos	81,103	64,731
Non-Military Equipment	642	-
Other	-	-
Base Realignment and Closure Installations		
Installation Restoration Program	-	-
Military Munitions Response Program	-	-
Environmental Corrective Action / Closure Requirements	-	-
Asbestos	-	-
Non-Military Equipment	-	-
Other	-	-
Environmental Disposal for Military Equipment / Weapons Programs		
Nuclear Powered Military Equipment / Spent Nuclear Fuel	-	-
Non-Nuclear Powered Military Equipment	-	-
Other Weapons Systems	-	-
Chemical Weapons Disposal Program		
Chemical Demilitarization - Chemical Materials Agency (CMA)	-	-
Chemical Demilitarization - Assembled Chemical Weapons Alternatives (ACWA)	-	-
Other	-	-
<b>Total Environmental Liabilities</b>	<b>\$ 212,064</b>	<b>\$ 189,204</b>

### Applicable Laws and Regulations for Cleanup Requirements

Laws and regulations that impact USMC's environmental cleanup requirements include the Comprehensive Environmental Response, Compensation, and Liability Act; the Resource Conservation and Recovery Act (RCRA) of 1976 as amended by the Hazardous and Solid Waste Amendments of 1984; the Clean Water Act (CWA) of 1977; the Federal Water Pollution Control Act, the Safe Drinking Water Act (SDWA), and the Clean Air Act (CAA) of 1970. The regulatory drivers for FY 2017's Other Environmental Liabilities (OEL) as a percentage of total OEL were: RCRA (58.2%), CAA (26.9%), SDWA (2.8%), CWA (11.5%), Other (0.6%).

### Description of the Types of Environmental Liabilities and Disposal Liabilities

USMC uses various hazardous chemicals and other toxins in the course of carrying out ongoing operational activities. Such substances are used in the recurring repair and maintenance of property, plant and equipment. OEL can stem from solid waste management unit cleanup; landfill closure; permitted facilities; removal, replacement, retro fill, and/or disposal of polychlorinated biphenyl transformers; and underground storage tank remedial investigation and closure.



USMC collects estimated environmental liability costs, via the NAVFAC OEL Program, for units at active USMC installations that are not a part of either the DERP or BRAC Program. OEL estimates are developed from field data collected by knowledgeable persons at USMC installations. OEL does not include environmental liabilities associated with weapons systems and/or radiological operational units. DERP and BRAC environmental liabilities are reported on the DON's financial statements.

#### Method for Assigning Estimated Total Cleanup Costs to Current Operating Periods

USMC expensed cleanup costs for GPP&E placed into service prior to October 1, 1997. USMC expenses cleanup costs associated with the asset life that has passed since the GPP&E was placed into service from October 1, 1997 forward. For GPP&E placed into service after September 30, 1997, USMC expenses associated environmental costs using two methods: physical capacity for operating landfills and life expectancy in years for all other assets. USMC expenses the full cost to clean up contamination for Stewardship PP&E at the time the asset is placed into service.

#### Method for Estimating Other Environmental Liabilities - Non-BRAC

OEL estimates are based on the following:

- Execution/payment amounts,
- Historical references (e.g. prior projects, investigations, monitoring),
- Current projects of comparable scope (similar sites),
- Estimates from vendors/contractors,
- Estimates from Military Construction Data Project form,
- Program Objectives Memorandum Guidebook, and
- Professional experience.

The OEL for a non-landfill unit placed in service prior to October 1, 1997 is estimated and reported at full cost. For a non-landfill unit placed in service on or after September 30, 1997, recognized cost is accrued on a straight-line basis from the date in service until its expected execution date. The OEL for a landfill is based on the percentage of its utilized capacity.

Reporting of asbestos OEL has been rolled out incrementally on a region-by-region basis over the past three years. After asbestos survey and field data are available at the time of demolition, independently validated engineering cost model estimates are used to estimate the facility environmental liability. When uncertainty exists about the extent of environmental damage or appropriate remediation measures, the estimate includes a range of contingent liability costs.

The reported liability for an asbestos unit depends on the facility date-in-service and its estimated useful life for accounting purposes. If the date-in-service is prior to October 1, 2012, the entire estimated environmental cost is immediately reportable as a liability. For an asbestos unit having a date-in-service on or after October 1, 2012, its estimated environmental liability is accrued over the useful life of the asset. The portion of estimated environmental disposal costs that has not yet been accrued as liability is reported as "Unrecognized Cost" discussed below.

#### Unrecognized Cleanup Costs

The unrecognized portion of cleanup costs is the unamortized portion of closure assets and asbestos, as well as un-utilized landfill capacity. As of September 30, 2017 and 2016, there were \$80.5 million and \$104.3 million of unrecognized other environmental liabilities, respectively.

USMC tangible property, plant, and equipment contain nonfriable asbestos. At this time, USMC developed estimates for non-friable asbestos abatement costs total \$81.1 million. USMC only reports non-friable asbestos. Friable asbestos is immediately remediated if discovered.

### Environmental Liabilities for Weapons Systems

USMC weapons systems utilize compounds, chemicals, and other hazardous materials for which environmental liabilities and the associated cleanup costs should be estimated and reported. USMC acknowledges that estimates for these cleanup costs are currently not being reported as described in Note 1.D, *Basis of Accounting*, as a GAAP departure.

### Nature of Estimates and the Disclosure of Information Regarding Possible Changes due to Inflation, Deflation, Technology, or Applicable Laws and Regulations

Environmental liabilities can change in the future because of changes in laws, regulations, regulatory agency agreements, technology advances, inflation, and changes to disposal plans. Costs for existing OEL estimates were escalated by 1.9% inflation in FY 2017 per the DoD Unified Facilities Criteria Pricing Guide, Change 13. USMC is unaware of pending regulatory changes that would affect OEL. Additions, deletions and adjustments to OEL due to changes in the unit universe are not reported until all environmental assessments are completed. USMC OEL totaled \$212.1 million as of September 30, 2017. This is an increase of \$22.9 million over the prior year and is mostly due to the fact that other environmental liabilities stemming from non-military assets in Defense Property Accountability System were added to the OEL estimate for the first time in FY 2017.

## **NOTE 15. OTHER LIABILITIES**

As of September 30 (Amounts in thousands)	Unaudited 2017		
	Current Liability	Noncurrent Liability	Total
<b>Intragovernmental</b>			
Advances from Others	\$ -	\$ -	\$ -
Deposit Funds and Suspense Account Liabilities	-	-	-
Disbursing Officer Cash	5,228	-	5,228
Judgment Fund Liabilities	-	-	-
FECA Reimbursement to the Department of Labor	17,070	20,366	37,436
Custodial Liabilities	91	-	91
Employer Contribution and Payroll Taxes Payable	10,488	-	10,488
Other Liabilities	13,599	-	13,599
Total Intragovernmental Other Liabilities	\$ 46,476	\$ 20,366	\$ 66,842
<b>Nonfederal</b>			
Accrued Funded Payroll and Benefits	\$ 65,475	\$ -	\$ 65,475
Advances from Others	1,982	-	1,982
Deferred Credits	-	-	-
Deposit Funds and Suspense Accounts	72,067	-	72,067
Temporary Early Retirement Authority	-	-	-
Nonenvironmental Disposal Liabilities			
Military Equipment (Nonnuclear)	-	-	-
Excess/Obsolete Structures	-	-	-
Conventional Munitions Disposal	-	-	-
Accrued Unfunded Annual Leave	732,832	-	732,832
Capital Lease Liability	-	-	-
Contract Holdbacks	58	3,835	3,893
Employer Contribution and Payroll Taxes Payable	29,271	-	29,271
Contingent Liabilities	589	86,247	86,836
Other Liabilities	-	-	-
Total Nonfederal Other Liabilities	\$ 902,274	\$ 90,082	\$ 992,356
<b>Total Other Liabilities</b>	<b>\$ 948,750</b>	<b>\$ 110,448</b>	<b>\$ 1,059,198</b>

As of September 30 (Amounts in thousands)	Unaudited 2016		
	Current Liability	Noncurrent Liability	Total
<b>Intragovernmental</b>			
Advances from Others	\$ -	\$ -	\$ -
Deposit Funds and Suspense Account Liabilities	-	-	-
Disbursing Officer Cash	4,618	-	4,618
Judgment Fund Liabilities	-	-	-
FECA Reimbursement to the Department of Labor	17,303	21,021	38,324
Custodial Liabilities	95	-	95
Employer Contribution and Payroll Taxes Payable	10,409	-	10,409
Other Liabilities	19,740	-	19,740
Total Intragovernmental Other Liabilities	\$ 52,165	\$ 21,021	\$ 73,186
<b>Nonfederal</b>			
Accrued Funded Payroll and Benefits	\$ 52,337	\$ -	\$ 52,337
Advances from Others	2,969	-	2,969
Deferred Credits	-	-	-
Deposit Funds and Suspense Accounts	86,661	-	86,661
Temporary Early Retirement Authority	-	-	-
Nonenvironmental Disposal Liabilities	-	-	-
Military Equipment (Nonnuclear)	-	-	-
Excess/Obsolete Structures	-	-	-
Conventional Munitions Disposal	-	-	-
Accrued Unfunded Annual Leave	725,949	-	725,949
Capital Lease Liability	-	-	-
Contract Holdbacks	51	542	593
Employer Contribution and Payroll Taxes Payable	17,869	-	17,869
Contingent Liabilities	-	129,794	129,794
Other Liabilities	-	-	-
Total Nonfederal Other Liabilities	\$ 885,836	\$ 130,336	\$ 1,016,172
<b>Total Other Liabilities</b>	<b>\$ 938,001</b>	<b>\$ 151,357</b>	<b>\$ 1,089,358</b>

#### Disbursing Officer Cash

The amount reported represents the corresponding liability for various forms of non-entity cash held by USMC disbursing officers such as: cash on hand, cash on deposit at designated depositories, negotiable instruments, and foreign currencies. The balance also includes the liability for disbursing officer recognized accounts receivable.

#### FECA Reimbursement to the Department of Labor

The amount represents workers compensation that is remitted to the DOL as required per the FECA.

#### Intragovernmental: Other Liabilities

The amount reported primarily consists of unemployment compensation liabilities.

#### Advances from Others

The balance represents funds received from non-federal entities in advance to cover future expenses or acquisition of assets.

#### Deposit funds and Suspense Accounts

The amount reported represent the corresponding liability for receipts held temporarily in deposit funds for distribution to another fund or entity or held as an agent for others to be paid at the direction of the owner.

### Contingent liabilities

The amount reported includes Outstanding Contract Financing Payments owed to the vendor as progress payments for cost incurred to date related to existing contracts in MOCAS. Contingent liabilities, also includes \$16 million in estimated legal liabilities. See Note 16 for additional information on *Commitments and Contingencies*.

## **NOTE 16. COMMITMENTS AND CONTINGENCIES**

### **Legal Contingencies**

USMC is a party in various administrative proceedings and legal actions, related to events such as aircraft, ship and vehicle accidents; property or environmental damage; contractual bid protests; and equal opportunity matters which may ultimately result in settlements or decisions adverse to the federal government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown.

The DON's Office of General Counsel (OGC) reviews litigation and claims threatened or asserted involving the USMC to which lawyers devote substantial attention in the form of legal consultation or representation.

The DON developed a methodology to determine an estimate for contingent legal liabilities for aggregated cases. The methodology approximates the percentage that has historically been paid on claims and the merits of each individual case are not taken into consideration. This item is reported as a GAAP departure in Note 1.D, *Basis of Accounting*.

USMC accrues contingent liabilities for legal actions where management considers an adverse decision probable and the amount of loss measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury's Judgment Fund. Also, adverse judgments may be payable from USMC resources, either directly or by reimbursement to the Judgment Fund. USMC reports contingent liabilities in Note 15, *Other Liabilities*.

### **Contingencies from Obligations Related to Canceled Appropriations**

USMC recognizes \$6.9 million of contingent liability for obligations related to canceled appropriations for which USMC still has a contractual commitment to pay vendors for goods provided and services rendered.



## NOTE 17. MILITARY RETIREMENT AND OTHER FEDERAL EMPLOYMENT BENEFITS

As of September 30 (Amounts in thousands)	Unaudited 2017		
	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
<b>Pension and Health Benefits</b>			
Military Retirement Pensions	\$ -	\$ -	\$ -
Military Pre Medicare-Eligible Retiree Health Benefits	-	-	-
Military Medicare-Eligible Retiree Health Benefits	-	-	-
Total Pension and Health Benefits	\$ -	\$ -	\$ -
<b>Other Benefits</b>			
FECA	\$ 184,718	\$ -	\$ 184,718
Voluntary Separation Incentive Programs	-	-	-
DoD Education Benefits Fund	-	-	-
Other	1,323	(1,323)	-
Total Other Benefits	\$ 186,041	\$ (1,323)	\$ 184,718
<b>Total Military Retirement and Other Federal Employment Benefits:</b>	<b>\$ 186,041</b>	<b>\$ (1,323)</b>	<b>\$ 184,718</b>

As of September 30 (Amounts in thousands)	Unaudited 2016		
	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
<b>Pension and Health Benefits</b>			
Military Retirement Pensions	\$ -	\$ -	\$ -
Military Pre Medicare-Eligible Retiree Health Benefits	-	-	-
Military Medicare-Eligible Retiree Health Benefits	-	-	-
Total Pension and Health Benefits	\$ -	\$ -	\$ -
<b>Other Benefits</b>			
FECA	\$ 181,129	\$ -	\$ 181,129
Voluntary Separation Incentive Programs	-	-	-
DoD Education Benefits Fund	-	-	-
Other	1,379	(1,379)	-
Total Other Benefits	\$ 182,508	\$ (1,379)	\$ 181,129
<b>Total Military Retirement and Other Federal Employment Benefits:</b>	<b>\$ 182,508</b>	<b>\$ (1,379)</b>	<b>\$ 181,129</b>

### Military Retirement Pensions

The portion of the military retirement benefits actuarial liability applicable to USMC is reported on the financial statements of the Military Retirement Fund.

### Military Health Benefits

USMC's budget is inclusive of funds received in support of its contribution to MERHCF; however, those funds have not been reported in these financial statement and disclosures as discussed at Note 1.D, *Basis of Accounting*.

### Civilian Retirement Benefits

USMC appropriations fund a portion of pension benefits for its civilian employees under the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS), and make the necessary payroll withholdings.



In accordance with SFFAS No. 5, OPM, the administering entity of the retirement systems, is responsible for reporting assets, accumulated plan benefits, and unfunded liabilities, if any, applicable to CSRS and FERS participants Government-wide.

#### Federal Employees Compensation Act

The FECA provides income and medical cost protection to covered Federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA program is administered by the DOL, which pays valid claims and subsequently seeks reimbursement from USMC for these paid claims.

The FECA liability consists of two components. The first component is based on actual claims paid by DOL but not yet reimbursed by USMC. USMC reimburses DOL for the amount of the actual claims as funds are appropriated for this purpose. There is generally a two to three year lag between payment by DOL and reimbursement by USMC. As a result, USMC recognizes a liability for the actual claims paid by DOL and to be reimbursed by USMC.

The second component is the actuarial liability that is estimated for future benefit payments as a result of past events. This liability includes death, disability, medical, and miscellaneous costs. The DOL determines this component annually, as of September 30, using a method that considers historical benefit payment patterns, wage inflation factors, medical inflation factors, and other variables. USMC recognizes an unfunded liability to the public for these estimated future payments. The liability is allocated between USMC and Navy Working Capital Fund-Marine Corps based on the number of civilian employees funded in each entity.

#### Other Benefits, Other

This amount consists primarily of voluntary separation incentive pay (VSIP) for former civilian employees. Due to a systems mapping issue, the amounts are reported in other benefits as opposed to the VSIP line item of the schedule. VSIP Authority, also known as “buyout” authority, is authorized by OPM and enables agencies that are downsizing or restructuring to offer employees lump-sum payments of up to \$25,000 as an incentive to voluntarily separate. Per OPM guidance, VSIP for civilian employees is calculated by taking the lesser of:

1. An amount equal to the amount of severance pay the employee would be entitled to receive, as computed under 5 U.S.C. 5595(c), without adjustment for any previous payment made; or
2. An amount determined by the agency head, not to exceed \$25,000.



## NOTE 18. GENERAL DISCLOSURES RELATED TO THE STATEMENT OF NET COST

### Intragovernmental Costs and Exchange Revenue

As of September 30 (Amounts in thousands)	Unaudited 2017	Unaudited 2016
<b>Military Retirement Benefits</b>		
Gross Cost		
Intragovernmental Cost	\$ -	\$ -
Nonfederal Cost	-	-
Total Cost	\$ -	\$ -
Earned Revenue		
Intragovernmental Revenue	\$ -	\$ -
Nonfederal Revenue	-	-
Total Revenue	\$ -	\$ -
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	\$ -	\$ -
Total Net Cost	\$ -	\$ -
<b>Civil Works</b>		
Gross Cost		
Intragovernmental Cost	\$ -	\$ -
Nonfederal Cost	-	-
Total Cost	\$ -	\$ -
Earned Revenue		
Intragovernmental Revenue	\$ -	\$ -
Nonfederal Revenue	-	-
Total Revenue	\$ -	\$ -
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	\$ -	\$ -
Total Net Cost	\$ -	\$ -
<b>Military Personnel</b>		
Gross Cost		
Intragovernmental Cost	\$ 2,208,368	\$ 2,279,423
Nonfederal Cost	11,286,699	11,172,852
Total Cost	\$ 13,495,067	\$ 13,452,275
Earned Revenue		
Intragovernmental Revenue	\$ (22,531)	\$ (24,343)
Nonfederal Revenue	(13,564)	(14,682)
Total Revenue	\$ (36,095)	\$ (39,025)
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	\$ -	\$ -
Total Net Cost	\$ 13,458,972	\$ 13,413,250
<b>Operations, Readiness &amp; Support</b>		
Gross Cost		
Intragovernmental Cost	\$ 2,485,591	\$ 1,782,840
Nonfederal Cost	4,631,053	6,698,108
Total Cost	\$ 7,116,644	\$ 8,480,948
Earned Revenue		
Intragovernmental Revenue	\$ (171,371)	\$ (168,828)
Nonfederal Revenue	(52,908)	(48,093)
Total Revenue	\$ (224,279)	\$ (216,921)
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	\$ -	\$ -
Total Net Cost	\$ 6,892,365	\$ 8,264,027
<b>Procurement</b>		
Gross Cost		

## Intragovernmental Costs and Exchange Revenue

As of September 30 (Amounts in thousands)	Unaudited 2017	Unaudited 2016
Intragovernmental Cost	\$ 528,052	\$ 611,554
Nonfederal Cost	1,828,191	1,067,500
Total Cost	\$ 2,356,243	\$ 1,679,054
Earned Revenue		
Intragovernmental Revenue	\$ (133,288)	\$ (8,748)
Nonfederal Revenue	(1)	-
Total Revenue	\$ (133,289)	\$ (8,748)
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	\$ -	\$ -
Total Net Cost	\$ 2,222,954	\$ 1,670,306
<b>Research, Development, Test &amp; Evaluation</b>		
Gross Cost		
Intragovernmental Cost	\$ 170,388	\$ 159,639
Nonfederal Cost	485,540	442,612
Total Cost	\$ 655,928	\$ 602,251
Earned Revenue		
Intragovernmental Revenue	\$ (5,424)	\$ (908)
Nonfederal Revenue	2	-
Total Revenue	\$ (5,422)	\$ (908)
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	\$ -	\$ -
Total Net Cost	\$ 650,506	\$ 601,343
<b>Family Housing &amp; Military Construction</b>		
Gross Cost		
Intragovernmental Cost	\$ -	\$ -
Nonfederal Cost	-	-
Total Cost	\$ -	\$ -
Earned Revenue		
Intragovernmental Revenue	\$ -	\$ -
Nonfederal Revenue	-	-
Total Revenue	\$ -	\$ -
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	\$ -	\$ -
Total Net Cost	\$ -	\$ -
<b>Consolidated</b>		
Gross Cost		
Intragovernmental Cost	\$ 5,392,399	\$ 4,833,456
Nonfederal Cost	18,231,483	19,381,072
Total Cost	\$ 23,623,882	\$ 24,214,528
Earned Revenue		
Intragovernmental Revenue	\$ (332,614)	\$ (202,827)
Nonfederal Revenue	(66,471)	(62,775)
Total Revenue	\$ (399,085)	\$ (265,602)
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	\$ -	\$ -
Costs Not Assigned to Programs	\$ -	\$ -
(Less: Earned Revenues) Not Attributed to Programs	\$ -	\$ -
Total Net Cost	\$ 23,224,797	\$ 23,948,926

## NOTE 19. GENERAL DISCLOSURES RELATED TO THE STATEMENT OF CHANGES IN NET POSITION

### Prior Period Adjustment in Fiscal Year 2016

USMC made adjustments to beginning balances using the “change in accounting principles” U.S. Standard General Ledger account at FY 2016 year end in anticipation of the FY 2017 audit. These entries were made to prepare the beginning balances for audit in the major asset accounts. Based on audit results and the status of remediation actions, USMC ultimately did not make an unreserved assertion during FY 2017, and did not have additional activity in this account as of FY 2017 year end.

### Reconciliation of Appropriations on the SBR to SCNP (Unaudited)

Period Ended September 30, 2017 (Amounts in millions)	Total
Appropriations, Statement of Budgetary Resources	\$ 24,120.5
Appropriations Received, Statement of Changes in Net Position	24,134.3
<b>Total Reconciling Amount</b>	<b>\$ 13.8</b>
<b>Items Reported as Reductions to Appropriations, Statement of Budgetary Resources</b>	
Permanent and Temporary Reductions	\$ -
Miscellaneous items, Transfers and Special Receipts and Appropriations Anticipated	(13.8)
<b>Total Reconciling Items</b>	<b>\$ 13.8</b>

Refer to Note 20, *General Disclosures Related to the Statement of Budgetary Resources*, for additional detail on the reconciling amount noted in this schedule.

## NOTE 20. GENERAL DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

As of September 30 (Amounts in thousands)	Unaudited 2017	Unaudited 2016
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 6,575,390	\$ 6,265,253
Available Borrowing and Contract Authority at the End of the Period	-	-

The Combined SBRs for FY17 and FY16 reflect \$22.0 billion and \$21.4 billion respectively of direct obligations in category A, amounts apportioned quarterly; \$2.3 billion and \$2.1 billion for FY17 and FY16 respectively of direct obligations in category B, amounts apportioned on a basis other than quarterly; and \$383.2 million and \$324.2 million for FY17 and FY16 respectively of reimbursable obligations in category B.

USMC does not receive permanent indefinite appropriations, contributed capital, or have any legal arrangements affecting the use of unobligated balances of budget authority.

Appropriations on the SBR do not agree with Appropriations Received on the SCNP because of differences between proprietary and budgetary accounting concepts and reporting concepts. There is a difference of (\$13.8) million which consists of transfers and permanent reductions to appropriations. These amounts are included on the SBR, but not reported on the SCNP. Refer to Note 19, *General Disclosures Related to the Statement of Changes in Net Position*.

## NOTE 21. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

As of September 30 (Amounts in thousands)	Unaudited 2017	Unaudited 2016
<b>Resources Used to Finance Activities:</b>		
Budgetary Resources Obligated:		
Obligations incurred	\$ 24,726,163	\$ 23,847,812
Less: Spending authority from offsetting collections and recoveries (-)	(1,249,119)	(1,284,337)
Obligations net of offsetting collections and recoveries	\$ 23,477,044	\$ 22,563,475
Less: Offsetting receipts (-)	6,467	(2,951)
Net obligations	\$ 23,483,511	\$ 22,560,524
Other Resources:		
Donations and forfeitures of property	-	-
Transfers in/out without reimbursement (+/-)	138,203	5,079
Imputed financing from costs absorbed by others	62,555	76,256
Other (+/-)	(2,483,361)	714,495
Net other resources used to finance activities	\$ (2,282,603)	\$ 795,830
<b>Total resources used to finance activities</b>	<b>\$ 21,200,908</b>	<b>\$ 23,356,354</b>
<b>Resources Used to Finance Items not Part of the Net Cost of Operations:</b>		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:		
Undelivered Orders (-)	\$ (310,137)	\$ 1,457,887
Unfilled Customer Orders	14,031	(26,561)
Resources that fund expenses recognized in prior Periods (-)	(178,752)	(267,123)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	(6,467)	2,951
Resources that finance the acquisition of assets (-)	(1,128,325)	(316,360)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:		
Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-)	-	-
Other (+/-)	2,342,447	(721,685)
<b>Total resources used to finance items not part of the Net Cost of Operations</b>	<b>\$ 732,797</b>	<b>\$ 129,109</b>
<b>Total resources used to finance the Net Cost of Operations</b>	<b>\$ 21,933,705</b>	<b>\$ 23,485,463</b>
<b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>		
Components Requiring or Generating Resources in Future Period:		
Increase in annual leave liability	\$ 7,512	\$ 1,069
Increase in environmental and disposal liability	22,860	-
Upward/Downward reestimates of credit subsidy expense (+/-)	-	-
Increase in exchange revenue receivable from the public (-)	-	(4,522)
Other (+/-)	4,032	29,061
Total components of Net Cost of Operations that will Require or Generate Resources in future periods	\$ 34,404	\$ 25,608
Components not Requiring or Generating Resources:		
Depreciation and amortization	\$ 1,255,428	\$ 416,499
Revaluation of assets or liabilities (+/-)	2,300	9,763
Other (+/-)		
Trust Fund Exchange Revenue	-	-
Cost of Goods Sold	-	-
Operating Material and Supplies Used	(526)	13,201
Other	(514)	(1,608)



As of September 30 (Amounts in thousands)	Unaudited 2017	Unaudited 2016
Total Components of Net Cost of Operations that will not Require or Generate Resources	\$ 1,256,688	\$ 437,855
<b>Total components of Net Cost of Operations that will not Require or Generate Resources in the current period</b>	<b>\$ 1,291,092</b>	<b>\$ 463,463</b>
<b>Net Cost of Operations</b>	<b>\$ 23,224,797</b>	<b>\$ 23,948,926</b>

This reconciliation shows the relationship between the net obligations derived from the SBR and net costs of operations derived from the SNC by identifying key items that affect one statement, but not the other.

In the “Resources Used to Finance Activities” section, line item, “Other Resources: Other” is primarily comprised of the year to date changes in general equipment, and operating material and supplies, including ammunition.

In the “Resources Used to Finance Items not Part of the Net Cost of Operations” section, line item, “Other, resources or adjustments to net obligated resources that do not affect Net Cost of Operations: Other” is comprised of general equipment, real property, and operating material and supplies, including ammunition. It also includes free issue from the DLA stock fund, unfilled customer orders with advances, transfers in/out without reimbursement.

The “Less: Offsetting receipts (-)” line item has an abnormal balance of \$6.5 million and the related line item “Budgetary offsetting collections and receipts that do not affect the Net Cost of Operations” has an abnormal (\$6.5) million balance. USMC recorded activity related to deposit/suspense accounts and Savings Deposit Program during the last quarter of FY 2017 that resulted in the abnormal balances.

“Components not Requiring or Generating Resources: Other, Other” is comprised of adjustments made to the allowance for bad debt expense related to public accounts receivable.

## NOTE 22. DISCLOSURES RELATED TO INCIDENTAL CUSTODIAL COLLECTIONS

USMC does not have incidental custodial collections.

## NOTE 23. FUNDS FROM DEDICATED COLLECTIONS

As of September 30 (Amounts in thousands)	Unaudited 2017				
	Harbor Maintenance Trust Fund	Rivers and Harbors Contributed and Advance Fund	Other Funds	Eliminations	Consolidated Total
<b>BALANCE SHEET</b>					
<b>ASSETS</b>					
Fund balance with Treasury	\$ -	\$ -	\$ 1,277	\$ -	\$ 1,277
Investments	-	-	-	-	-
Accounts and Interest Receivable	-	-	-	-	-
Other Assets	-	-	-	-	-
Total Assets	\$ -	\$ -	\$ 1,277	\$ -	\$ 1,277
<b>LIABILITIES and NET POSITION</b>					
Accounts Payable and Other Liabilities	-	-	65	-	65
Total Liabilities	\$ -	\$ -	\$ 65	\$ -	\$ 65
Unexpended Appropriations	-	-	-	-	-
Cumulative Results of Operations	-	-	1,212	-	1,212
Total Liabilities and Net Position	\$ -	\$ -	\$ 1,277	\$ -	\$ 1,277
For the period ended September 30 (Amounts in thousands)	Unaudited 2017				
	Harbor Maintenance Trust Fund	Rivers and Harbors Contributed and Advance Fund	Other Funds	Eliminations	Consolidated Total
<b>STATEMENT OF NET COST</b>					
Program Costs	\$ -	\$ -	\$ 141	\$ -	\$ 141
Less Earned Revenue	-	-	-	-	-
Net Program Costs	\$ -	\$ -	\$ 141	\$ -	\$ 141
Less Earned Revenues Not Attributable to Programs	-	-	-	-	-
Net Cost of Operations	\$ -	\$ -	\$ 141	\$ -	\$ 141
For the period ended September 30 (Amounts in thousands)	Unaudited 2017				
	Harbor Maintenance Trust Fund	Rivers and Harbors Contributed and Advance Fund	Other Funds	Eliminations	Consolidated Total
<b>STATEMENT OF CHANGES IN NET POSITION</b>					
Net Position Beginning of the Period	\$ -	\$ -	\$ 1,229	\$ -	\$ 1,229
Net Cost of Operations	-	-	141	-	141
Budgetary Financing Sources	-	-	124	-	124
Other Financing Sources	-	-	-	-	-
Change in Net Position	\$ -	\$ -	\$ (17)	\$ -	\$ (17)
Net Position End of Period	\$ -	\$ -	\$ 1,212	\$ -	\$ 1,212

As of September 30 (Amounts in thousands)	Unaudited 2016					
	Harbor Maintenance Trust Fund	Rivers and Harbors Contributed and Advance Fund	Other Funds	Eliminations	Consolidated Total	
<b>BALANCE SHEET</b>						
<b>ASSETS</b>						
Fund balance with Treasury	\$	-	\$	-	\$	1,283
Investments		-		-		-
Accounts and Interest						
Receivable		-		-		-
Other Assets		-		-		-
Total Assets	\$	-	\$	-	\$	1,283
<b>LIABILITIES and NET POSITION</b>						
Accounts Payable and Other						
Liabilities		-		-		54
Total Liabilities	\$	-	\$	-	\$	54
Unexpended Appropriations		-		-		-
Cumulative Results of						
Operations		-		-		1,229
Total Liabilities and Net Position	\$	-	\$	-	\$	1,283

For the period ended September 30 (Amounts in thousands)	Unaudited 2016					
STATEMENT OF NET COST	Harbor Maintenance Trust Fund	Rivers and Harbors Contributed and Advance Fund	Other Funds	Eliminations	Consolidated Total	
Program Costs	\$ -	\$ -	\$ 76	\$ -	\$ 76	
Less Earned Revenue	-	-	-	-	-	
Net Program Costs	\$ -	\$ -	\$ 76	\$ -	\$ 76	
Less Earned Revenues Not Attributable to Programs	-	-	-	-	-	
Net Cost of Operations	\$ -	\$ -	\$ 76	\$ -	\$ 76	

For the period ended September 30 (Amounts in thousands)	Unaudited 2016				
STATEMENT OF CHANGES IN NET POSITION	Harbor Maintenance Trust Fund	Rivers and Harbors Contributed and Advance Fund	Other Funds	Eliminations	Consolidated Total
Net Position Beginning of the Period	-	-	1,182	-	1,182
Net Cost of Operations	-	-	76	-	76
Budgetary Financing Sources	-	-	123	-	123
Other Financing Sources	-	-	-	-	-
Change in Net Position	\$ -	\$ -	\$ 47	\$ -	\$ 47
Net Position End of Period	\$ -	\$ -	\$ 1,229	\$ -	\$ 1,229

Funds from dedicated collections are financed by specifically identified revenues and other financing sources and are provided to the government by non-federal sources. The funds from dedicated collections are required by statute to be used for designated activities, benefits, or purposes that must be accounted for separately from the government's general

revenues. USMC's dedicated collections are generated from the Wildlife Conservation, Military Installations fund and is included within the Other Funds in the footnote schedule.

### **Wildlife Conservation, Military Installations, 16 USC 670**

This fund provides for the development and conservation of fish and wildlife and recreational facilities on military installations. Revenues come from user fees that are charged to individuals in exchange for fishing and hunting permits. The permits allow for hunting and fishing to take place on certain USMC installations. These programs are carried out through cooperative plans agreed upon by the local representatives of the Secretary of Defense, the Secretary of the Interior, and the appropriate agency of the state in which the installation is located.

The non-exchange revenue from the Wildlife Conservation, Military Installation fund is accounted for and reported as described under Note 1.E, *Revenues and Other Financing Sources*.

## **NOTE 24. FIDUCIARY ACTIVITIES**

### **Schedule of Fiduciary Activity**

For the period ended September 30 (Amounts in thousands)	Unaudited 2017	Unaudited 2016
Fiduciary net assets, beginning of year	\$ 42,193	\$ 24,844
Fiduciary revenues	-	-
Contributions	(1,091)	1
Investment earnings	289	262
Gain (Loss) on disposition of investments, net	-	-
Administrative and other expenses	-	-
Distributions to and on behalf of beneficiaries	(37,628)	17,086
Increase/(Decrease) in fiduciary net assets	\$ (38,430)	\$ 17,349
<b>Fiduciary net assets, end of period</b>	<b>\$ 3,763</b>	<b>\$ 42,193</b>

### **Schedule of Fiduciary Net Assets**

As of September 30 (Amounts in thousands)	Unaudited 2017	Unaudited 2016
<b>FIDUCIARY ASSETS</b>		
Cash and cash equivalents	\$ 3,763	\$ 42,193
Investments	-	-
Other Assets	-	-
<b>FIDUCIARY LIABILITIES</b>		
Less: LIABILITIES	\$ -	\$ -
<b>TOTAL FIDUCIARY NET ASSETS</b>	<b>\$ 3,763</b>	<b>\$ 42,193</b>

SFFAS 31, *Accounting for Fiduciary Activities*, defines "fiduciary activities" as, "those Federal Governmental activities that relate to the collection or receipt, and the subsequent management, protection, accounting, investment and disposition of cash or other assets in which non-federal individuals or entities ("non-federal parties") have an ownership that the Federal Government must uphold.

USMC's fiduciary activities consist of the TSP and the SDP. The TSP is a government-sponsored retirement savings and investment plan that was authorized by the Federal Employees' Retirement System Act of 1986 (5 U.S.C 84), which authorized USMC to collect contributions through payroll deductions on behalf of Marines and civilian employees. The TSP balance included in this note disclosure represents the balances that have not yet been transferred to the corresponding administering agency.

The SDP was authorized by Executive Order 11298 (August 14, 1966). It authorizes USMC to withhold up to \$10,000 of pay for every Marine serving in a designated combat zone or in direct support of a combat zone, and deposit those funds in savings deposit account that earns 10% interest per annum, compounded quarterly. Any member serving in an area that has been designated a combat zone or is in direct support of a combat zone is eligible to participate in the SDP after the member has served in that assignment for at least 30 consecutive days or at least one day for each of three consecutive months.



## REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION

Unaudited, see accompanying Independent Auditors' Report.

Investment in future weaponry and technologies is vital for the USMC's mission. RDT&E is one of the five major appropriation streams received by USMC. RDT&E finances efforts performed by both contractors and government installations to develop equipment, material, and computer application software. Funding covers items such as government and civilian salaries, equipment, components, materials, and weapons. RDT&E is a multi-year appropriation that remains available for obligation for a period of two fiscal years. As federal spending as tightened, USMC is required to do more with less. Consequently, funding levels for RDT&E has decreased significantly since FY 2013, as have related RDT&E liquidations/disbursements.

All DoD appropriations are budgeted with categories called Budget Activities (BAs). Four BAs, BAs 04 through 07, pertain directly to USMC. These BAs differentiate the purposes, projects, or types of activities financed by RTD&E. BAs 04 and 05 cover efforts used to fully develop and acquire integrated weapon systems, respectively. Programs in these budget activities may perform efforts necessary to further mature a technology or conduct engineering and manufacturing development tasks. BA 06 funds efforts to sustain or modernize the installations or operations required for general RDT&E. Work areas covered in BA 06 include test ranges, military construction, maintenance support of laboratories, studies and analyses, and operations and maintenance of test aircraft and ships. Budget activity 07 is used to designate research and development efforts for systems that have already been approved for production or those that have already been fielded.

(Amounts in thousands)		RDT&E Appropriation: Disbursements as of September 30, 2017					
Budget Activity	Title	2013	2014	2015	2016	2017	Total
04	Advanced Component Development and Prototypes (ACD&P)	\$325,380	\$245,302	\$267,806	\$386,725	\$124,570	\$1,349,783
05	System Development and Demonstration	\$22,388	\$8,860	\$5,065	\$5,775	\$2,448	\$44,536
06	RDT&E Management Support	\$74,784	\$96,611	\$64,596	\$50,077	\$36,595	\$322,663
07	Operational Systems Development	\$986,344	\$844,374	\$771,209	\$570,958	\$315,885	\$3,488,770
<b>Total</b>		<b>\$1,408,896</b>	<b>\$1,195,147</b>	<b>\$1,108,676</b>	<b>\$1,013,535</b>	<b>\$479,498</b>	<b>\$5,205,752</b>

**TABLE 1. DISBURSEMENTS FOR USMC R&D INVESTMENT ACTIVITY**

**Budget Activity 04, Advanced Component Development and Prototypes (ACD&P).** ACD&P work seeks to evaluate integrated technologies, representative modes, or prototype systems in a high fidelity and realistic operating environment. System-specific efforts are undertaken that help expedite technology transition from the laboratory to operational use. Emphasis is on proving component and subsystem maturity prior to integration in major and complex systems and may involve risk reduction initiatives.

In FY 2017, five primary programs were in progress to include the Amphibious Combat Vehicle (ACV) 1.1, Anti-Armor Weapon System-Heavy, the follow-on to the Shoulder Launcher Multi-Purpose Assault Weapon, Joint Non-Lethal Weapons, and the Joint Light Tactical Vehicle program. The ACV is an armored personnel carrier, balanced in performance, protection, and payload for employment within the Ground Combat Element and throughout the range of military operations, to include a swim capability. FY 2017 ACV activities include engineering, manufacturing and development; testing and evaluation activities; and associated program support for which USMC disbursed \$34.9 million.

**Budget Activity 05, System Development and Demonstration (SDD).** SDD programs are conducting engineering and manufacturing development tasks aimed at meeting validated requirements prior to full-rate production. Prototype performance is near or at planned operational system levels in these cases.



The most significant projects funded under this are Marine Corps Enterprise IT Services (MCEITS), Marine Corps Recruiting Information Support Systems, Safety, and Cyber Operations Technology Development. MCEITS provides an overarching portfolio of capabilities to deliver “Power to the Edge” for USMC. Born from an effort to establish a continuity of operations plan for USMC’s automated information systems, MCEITS enables realignment of the existing USMC environment of applications, databases, networks, and facilities into an integrated architecture of programs to deliver new information technology capabilities based on a common infrastructure and shared services. MCEITS is using an incremental acquisition approach implemented in separate releases followed by pre-planned product improvements delivering capabilities faster and more efficiently. The program will deliver an initial capability and continue integration and production in accordance with the USMC Information Enterprise Strategy. USMC disbursed approximately \$1.1 million in FY 2017 for the MCEITS program.

**Budget Activity 06, RDT&E Management Support.** RD&TE Management Support endeavors are aimed at the sustainment and/or modernization of the installations or operations required for general research, development, test, and evaluation. Test ranges, military construction, maintenance support of laboratories, operation and maintenance of test aircraft and ships, and studies and analyses in support of the RDT&E program are funded in this budget activity. Costs of laboratory personnel, either in-house or contractor operated, are assigned to projects, as appropriate.

Four projects of focus in FY 2017 were the Family of Incident Response Systems, Marine Corps Operational Test & Evaluation Activity (MCOTEA), Center for Naval Analyses, and Marine Corps Studies and Analysis. MCOTEA supports the material acquisition process and performs other functions at the instruction of the Commandant of the Marine Corps. MCOTEA must ensure that the Marines in the Operating Forces receive the very best possible equipment and support and thoroughly vets each system proposed for acquisition. Additionally, MCOTEA’s early involvement, coordination, and oversight in developmental testing and evaluation of new combat and combat support systems ensures that our Marines are the best trained, and have the best equipment, with the lowest test costs for taxpayers. The MCOTEA program accounted for approximately \$8.7 million of disbursements during FY 2017.

**Budget Activity 07, Operational System Development.** Operation System Development includes efforts to upgrade systems that have been fielded or have received approval for full rate production and anticipate production funding in the current or subsequent fiscal year. Program control is exercised by review of individual projects. Programs in this category involve systems that have received approval for Low Rate Initial Production.

In FY 2017, there are multiple programs funded under this budget activity. The Ground/Air Task Oriented Radar (G/ATOR) is a multi-role, ground-based, expeditionary radar that replaces five legacy radar systems for the Marine Air Ground Task Force (MAGTF). It satisfies the Marine Air Command and Control System (G/ATOR Block 1) and the Ground Counter Fire/Counter Battery (G/ATOR Block 2) capabilities. The G/ATOR will provide mobile, multi-functional, three-dimensional surveillance of air breathing targets, detection of cruise missiles, and the cueing of air defense weapons to allow Naval forces to project and sustain power deep inland. BA 07 also includes the Assault Amphibious Vehicle (AAV) program. This program provides life-cycle support to ensure cost-effective combat readiness for the AAV family of vehicles. This is accomplished through engineering changes resulting from continuous review of sub-systems to maintain system supportability, safety, reduce total ownership costs, improve fleet readiness, address obsolescence issues, and improve vehicle survivability and performance. AAV is currently undergoing several efforts to upgrade systems that have been fielded to include electrical modernization, underbelly protection, integrated blast mitigating seats, along with several other upgrades. Another BA 07 project in FY 2017 was the Ground Based Air Defense (GBAD) program. Based upon the deployment of the Low Altitude Air Defense Battalions and their employment of the Stinger Missile, GBAD transforms air defense equipment through technology insertion and equipment repackaging to address capability gaps as the result of equipment obsolescence and the emergent and evolving threats to the MAGTF. The GBAD Program is rapidly approaching the out of production phase for the A-MANPADS Increment I and the end of life for the Stinger missile. FY 2017 RDT&E disbursements for these three programs were approximately \$106.8 million.

## REQUIRED SUPPLEMENTARY INFORMATION

Unaudited, see accompanying Independent Auditors' Report.

### REAL PROPERTY DEFERRED MAINTENANCE AND REPAIRS

REAL PROPERTY DEFERRED MAINTENANCE						
(Amounts in thousands)	Fiscal Year Ended September 30, 2017			Fiscal Year Ended September 30, 2016		
	1. Plant Replacement Value	2. Required Work (deferred maintenance)	3. Percentage	1. Plant Replacement Value	2. Required Work (deferred maintenance)	3. Percentage
<b>Property Type</b>						
1. Category 1: Buildings, Structures, and Utilities (Enduring Facilities)	\$61,997,018	\$9,434,682	15.22%	\$53,930,898	\$8,669,381	16.07%
2. Category 2: Buildings, Structures, and Utilities (Heritage assets)	\$4,088,585	\$914,685	22.37%	\$3,743,423	\$837,754	22.38%
3. Category 3: Buildings, Structures, and Utilities (Excess Facilities or Planned for Replacement)	\$105,277	\$0	0.00%	\$56,488	\$0	0.00%

Description of Property Type categories:

- Category 1 – Buildings, Structures, and Utilities that are enduring and required to support an ongoing mission, excluding multi-use Heritage Assets
- Category 2 – Buildings, Structures, and Utilities that are Heritage Assets
- Category 3 – Buildings, Structures, and Utilities that are excess to requirements or planned for replacement or disposal, excluding multi-use Heritage Assets

Maintenance and repairs that were not performed on real property assets when they should have been or were scheduled and delayed for a future period are considered deferred maintenance and repairs (DM&R). The primary factors considered in determining acceptable condition standards align to restoring a real property facility, system, or component to such a condition that it may effectively be used for its designated functional purpose. Anything less is considered DM&R. DM&R for the USMC is not restricted to capitalized real property. Prioritization of maintenance needs are assigned based on the asset impact to mission critical functions, health and safety, and quality of life.

The maintenance and repair needs of real property assets are identified primarily through the condition assessment process, which is conducted on a recurring basis depending on the asset type. The method used to assess USMC facilities conditions is two-fold. All buildings, paving, bridges, and dams are inspected using the Sustainment Management Systems methodology developed by the US Army Corps of Engineers Civil Engineering Research Laboratory which provides a facilities condition index (FCI) for these assets. Remaining assets are assessed via local facilities inspections to address the adequacy of the facilities to meet its intended purpose. Assets inspected using both methods use the FCI to determine the assets' Quality rating (Q-rating) as follows: FCI of 100%-90% Q1 (Good); 90%-80% Q2 (Fair); 80%-60% Q3 (Poor); and less than 60% Q4 (Failing).

The USMC follows the Office of the Secretary of Defense Installation Strategic Plan goal of having facilities at a Q2 level on average as an acceptable rating. This represents an average level of 20% of Plant Replacement Value (PRV) as an acceptable level of deferred maintenance. The table above shows that deferred maintenance is valued at approximately 15.22% and 22.37% of PRV for categories 1 and 2, respectively. Category 3 is zero because USMC does not hold deferred maintenance backlogs on facilities to be demolished.

## GENERAL EQUIPMENT DEFERRED MAINTENANCE AND REPAIRS

USMC's GE consists of equipment used to execute battlefield missions, referred to as Military Equipment (ME), and property to support operations of installations and its tenant activities, referred to as Garrison Property. ME is broken down in to the categories of Communications – Electronics, Engineer, General Supply, Motor Transport, and Ordnance. Ordnance ME are generally weapons systems and are distinguished from ammunition reported as OM&S.

USMC maintenance and repair (M&R) procedures involve preventive and corrective maintenance. Preventive maintenance, checks and services (PMCS) are performed periodically (i.e. weekly, bi-weekly, monthly) to preserve the useful life of GE. PMCS are mandatory routine maintenance procedures for all GE. Maintenance managers at all levels rank and prioritize maintenance based on mission, condition of the equipment, and available resources (i.e. parts, mechanic/technician, time, facilities, etc.). Consistent with the "Marine Corps Integrated Maintenance Management System Field Procedures Manual," maintaining the useful life of an asset is in the interest of the USMC. DM&R activity is tracked and reported for capitalized (including fully depreciated assets) and expensed GE.

### Military Equipment Maintenance

For each category of ME, there is a corresponding technical manual that specifies how maintenance procedures are performed if an asset is non-mission capable/requires significant maintenance to continue in operations (referred to as deadline) or requires minor maintenance (referred to as degraded). When routine M&R procedures (both preventive and corrective maintenance) of ME will not be performed, the ME will be assigned to the Deferred Maintenance Program.

GENERAL PROPERTY, PLANT & EQUIPMENT - MILITARY EQUIPMENT		
Deferred Maintenance and Repairs (DM&R) for Fiscal Year Ended September 30, 2017		
<i>(Amounts in thousands)</i>		
Communications Electronics (e.g. radios, satellites, radar)	\$	12,938
Engineer (e.g. generators, bulldozers, earth movers)		9,428
General Supply (e.g. tents, water cans, fuel cans)		120
Motor Transport (e.g. ground-wheeled vehicles)		367,914
Ordnance (e.g. tanks, howitzers)		19,183
<b>Total</b>	<b>\$</b>	<b>409,583</b>

*\*USMC did not maintain DM&R estimates during fiscal year 2016.*

**FIGURE 4. GPP&E – MILITARY EQUIPMENT DM&R**

The "Field-Level Maintenance Management Policy" states that Commanders define their Deferred Maintenance Program and are classified as either Administrative Deadline Programs (ADL) or Administrative Storage Programs (ASP). They are both methods of deferring maintenance that allows commanders to preserve resources when operational conditions allow. The major distinction between the two is the maximum amount of time an asset can be enlisted in each program. DM&R estimates vary between the two programs and assets are not assigned based on the cost of repair. Major Commands or Major Subordinate Command Commanders are authorized to establish or operate an ASP. Unit Commanders operating an ASP will ensure equipment inducted into the ASP are stored at least 18 months and no more than 36 months. Commanding officers may authorize, establish, and operate an ADL program when equipment inducted into the ADL program is stored less than 18 months. Both ASP and ADL assets are maintained and reported in a mission capable status; are current on all scheduled PMCS prior to induction into the program; are visually inspected quarterly; are exercised semi-annually; have PMCS conducted/validated upon removal; are up to date on corrosion prevention and control assessment and servicing; and have a corrosion category code condition 3 or better.

GPP&E ME will be moved into the Deferred Maintenance Program according to the policies established in the ADL or ASP. Delegation of ME into ADL or ASP are at the Commander's discretion based on the Commander's assessment of the current operational conditions. For example, more equipment may be assigned in ADL or ASP during peacetime versus if active combat campaigns are ongoing. If corrective maintenance cannot be performed (e.g. lack of resources, mission prioritization), units may "evacuate" (transfer) the asset to the Marine Corps Intermediate Maintenance

Activity (IMA) located at the installation. If the IMA is unable to perform the required maintenance, the asset will be “evacuated” to Depot-level Maintenance at Marine Corps Logistics Command in either Albany, GA or Barstow, CA. The Depot is able to conduct maintenance and repair activity that the Operating Forces are not equipped to perform based on machinery requirements and technicians. The ME at depot level maintenance is in the Enterprise Life Cycle Maintenance Program (ELMP).

GPP&E ME Enrolled in ASP or ADL		
For Fiscal Year Ended September 30, 2017		
<i>(Amounts in thousands)</i>	Quantity	Estimated DM&R Ending Balance
<b>Military Equipment Commodity Classification</b>		
Communications Electronics	10	\$ 6
Engineer	101	3,426
General Supply	21	120
Motor Transport	601	307,447
Ordnance	8	3,223
<b>Total</b>	<b>741</b>	<b>\$ 314,222</b>

**FIGURE 5. ASP/ADL DM&R**

The Marine Expeditionary Forces (MEFs) identified 741 GPP&E ME in ASP/ADL as of September 30, 2017. Performance of periodic PMCS on these assets are postponed based on the operational needs of Commands. To determine the total DM&R costs associated with the ADL and ASP for fiscal year 2017, Marine Corps Systems Command provided total annual labor hours and total annual cost of parts and supplies for GPP&E ME. Based on the information provided by the MEFs and Marine Corps Systems Command, it is estimated that there is approximately \$314 million in DM&R costs associated with the assets in the ASP and ADL programs as of September 30, 2017.

## Enterprise Lifecycle Maintenance Program

GPP&E ME in ELMP		
For Fiscal Year Ended September 30, 2017		
<i>(Amounts in thousands)</i>	Quantity	Estimated DM&R Ending Balance
<b>Military Equipment Commodity Classification</b>		
Communications - Electronics	35	\$ 12,932
Engineer	43	6,002
Motor Transport	226	60,467
Ordnance	47	15,960
<b>Total</b>	<b>351</b>	<b>\$ 95,361</b>

**FIGURE 6. GPP&E – ELMP DM&R**

At the end of fiscal year 2017, Marine Corps Logistics Command identified 351 GPP&E ME in ELMP awaiting DM&R. As of September 30, 2017, GPP&E ME in ELMP has a total estimated DM&R cost of approximately \$95 million. ELMP is defined as an enhanced, collaborative approach to maintenance planning based on USMC operational needs and is completed annually. Once an asset class has been planned for ELMP, completion of ELMP maintenance can be delayed for various reasons, such as funding, personnel, and parts availability constraints.

## Deferred Maintenance and Repairs Integrated Project Team

During fiscal year 2017, USMC aligned policies and procedures with SFFAS No. 40, *Deferred Maintenance and Repairs: Definitional Changes*, and SFFAS No. 42, *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29, and 32*, and established a DM&R Integrated Project Team (IPT). The DM&R IPT was established to enhance the accountability of the DM&R programs and the reported estimated activities and costs. The DM&R IPT continues to tackle issues including:

- Obtaining a greater understanding of accountability over delayed GPP&E ME modifications;
- Recording dates properly when GPP&E ME are placed and removed from DM&R programs and ensuring appropriate DM&R program classification;
- Obtaining a greater understanding of costs associated with GPP&E DM&R activities;
- Ranking and prioritization of M&R activities among the Commands; and,
- Conducting cost-benefit analyses on GPP&E ME prior to them being placed in M&R activities.



# COMBINING STATEMENT OF BUDGETARY RESOURCES

For the period ended September 30, 2017

(unaudited)

	Research, Development, Test & Evaluation	Procurement	Military Personnel	Operations, Readiness & Support	2017 Combined
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(in thousands)

## Budgetary Resources:

Unobligated balance brought forward, Oct 1	\$ 88,515	\$ 534,586	\$ 628,166	\$ 601,727	\$ 1,852,994
Adjustment to unobligated balance brought forward, Oct 1 (+ or -)	-	-	-	-	-
Unobligated balance brought forward, Oct 1, as adjusted	88,515	534,586	628,166	601,727	1,852,994
Recoveries of unpaid prior year obligations	29,854	81,446	228,594	460,212	800,106
Other changes in unobligated balance (+ or -)	(21,131)	(85,448)	(174,154)	(279,228)	(559,961)
Unobligated balance from prior year budget authority, net	97,238	530,584	682,606	782,711	2,093,139
Appropriations (discretionary and mandatory)	591,702	1,884,454	13,618,683	8,025,649	24,120,488
Borrowing Authority (discretionary and mandatory)	-	-	-	-	-
Contract Authority (discretionary and mandatory)	-	-	-	-	-
Spending Authority from offsetting collections (discretionary and mandatory)	3,985	132,118	36,345	273,381	445,829
<b>Total Budgetary Resources</b>	<b>\$ 692,925</b>	<b>\$ 2,547,156</b>	<b>\$14,337,634</b>	<b>\$ 9,081,741</b>	<b>\$ 26,659,456</b>

## Status of Budgetary Resources:

New obligations and upward adjustments (total)	602,769	1,805,814	13,732,059	8,585,521	24,726,163
Unobligated balance, end of year:	-	-	-	-	-
Apportioned, unexpired accounts	67,576	568,625	45,572	25,617	707,390
Exempt from apportionment, unexpired accounts	-	-	-	-	-
Unapportioned, unexpired accounts	-	-	-	-	-
Unexpired unobligated balance, end of year	67,576	568,625	45,572	25,617	707,390
Expired unobligated balance, end of year	22,580	172,715	560,003	470,605	1,225,903
Unobligated balance, end of year (total)	90,156	741,340	605,575	496,222	1,933,293
<b>Total Budgetary Resources</b>	<b>\$ 692,925</b>	<b>\$ 2,547,154</b>	<b>\$14,337,634</b>	<b>\$ 9,081,743</b>	<b>\$ 26,659,456</b>

## Change in Obligated Balance:

Unpaid obligations:

Unpaid obligations, brought forward, Oct 1	\$ 520,692	\$ 2,466,276	\$ 614,375	\$ 3,667,246	\$ 7,268,589
Adjustment to unpaid obligations, start of year (+ or -)	-	-	-	-	-
New obligations and upward adjustments	602,769	1,805,814	13,732,059	8,585,521	24,726,163
Outlays (gross) (-)	(669,154)	(1,582,191)	(13,574,337)	(7,869,375)	(23,695,057)
Actual transfers, unpaid obligations (net) (+ or -)	-	-	-	-	-



(unaudited)

	Research, Development, Test & Evaluation	Procurement	Military Personnel	Operations, Readiness & Support	2017 Combined
(in thousands)					
Recoveries of prior year unpaid obligations (-)	(29,854)	(81,446)	(228,594)	(460,212)	(800,106)
Unpaid obligations, end of year	424,453	2,608,453	543,503	3,923,180	7,499,589
Uncollected payments:	-	-	-	-	-
Uncollected pymts, Fed sources, brought forward, Oct 1 (-)	(3,642)	(6,773)	(4,244)	(65,980)	(80,639)
Adj to uncollected pymts, Fed sources, start of year (+ or -)	-	-	-	-	-
Change in uncollected pymts, Fed sources (+ or -)	(204)	2,904	(94)	(6,101)	(3,495)
Actual transfers, uncollected pymts, Fed sources (net) (+ or -)	-	-	-	-	-
Uncollected pymts, Fed sources, end of year (-)	(3,846)	(3,869)	(4,338)	(72,081)	(84,134)
Memorandum Entries:					
Obligated balance, start of year (+ or -)	517,050	2,459,503	610,131	3,601,266	7,187,950
<b>Obligated balance, end of year (+ or -)</b>	<b>\$ 420,606</b>	<b>\$ 2,604,585</b>	<b>\$ 539,165</b>	<b>\$ 3,851,099</b>	<b>\$ 7,415,455</b>

**Budget Authority and Outlays, Net:**

Budget authority, gross (discretionary and mandatory)	\$ 595,687	\$ 2,016,572	\$13,655,028	\$ 8,299,030	\$ 24,566,317
Actual offsetting collections (discretionary and mandatory) (-)	(3,780)	(135,022)	(39,431)	(267,286)	(445,519)
Change in uncollected payments, Federal Sources (discretionary and mandatory) (+ or -)	(204)	2,904	(94)	(6,101)	(3,495)
Recoveries of prior year paid obligations (discretionary and mandatory)	-	-	3,180	5	3,185
Anticipated offsetting collections (discretionary and mandatory) (+ or -)	-	-	-	-	-
Budget Authority, net (total) (discretionary and mandatory)	<u>\$ 591,703</u>	<u>\$ 1,884,454</u>	<u>\$13,618,683</u>	<u>\$ 8,025,648</u>	<u>\$ 24,120,488</u>
Outlays, gross (discretionary and mandatory)	669,154	\$ 1,582,191	\$13,574,337	\$ 7,869,375	\$ 23,695,057
Actual offsetting collections (discretionary and mandatory) (-)	(3,780)	(135,022)	(39,431)	(267,286)	(445,519)
Outlays, net (total) (discretionary and mandatory)	665,374	1,447,169	13,534,906	7,602,089	23,249,538
Distributed offsetting receipts (-)	-	-	-	6,467	6,467
<b>Agency Outlays, net (discretionary and mandatory)</b>	<u>\$ 665,374</u>	<u>\$ 1,447,169</u>	<u>\$13,534,906</u>	<u>\$ 7,608,556</u>	<u>\$ 23,256,005</u>



## **SECTION 3:** Other Information

# SUMMARY OF FINANCIAL STATEMENT AUDIT AND MANAGEMENT ASSURANCES

Table 1 represents the results of previous independent audits. The material weaknesses reported in the annual United States Marine Corps (USMC) Statement of Assurance have not been analyzed in relation to USMC's comprehensive enterprise risk management program because it is in the early stages of development. As such, these material weakness conditions have not been assessed to confirm their severity in relation to the impact to the financial statements or overall USMC operations and is excluded from Table 2.

**Table 1. Summary of Financial Statement Audit**

Audit Opinion: Disclaimer					
Restatement: No					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Lack of Marine Corps oversight over DFAS	1	-	-	-	1
Inadequate management review and oversight of Marine Corp's financial reporting	1	-	-	-	1
Improper application of federal accounting standards and guidelines	1	-	-	-	1
Invalid authorization of obligations	1	-	-	-	1
Inability to maintain adequate documentation	1	-	-	-	1
Inadequate A-123 internal Control Program	1	-	-	-	1
<b>Total Material Weaknesses</b>	<b>6</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>6</b>

**Table 2. Summary of Management Assurances**

Compliance with Federal Financial Management System Requirements (FMFIA § 4)						
Statement of Assurance: Modified; Federal Systems comply, except for instances of non-compliance						
Non-Compliance	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Global Combat Support System – Marine Corps (GCSS-MC)	1	-	-	-	-	1
Marine Corps Certification and Accreditation (C&A) Process	1	-	-	-	-	1
Standard Accounting, Budgeting, and Reporting System (SABRS).	1	-	-	-	-	1
Financial Reporting for Operating Materials and Supplies (OM&S) Held at Marine Corps Logistics Command.	-	1	-	-	-	1
<b>Total non-compliances</b>	<b>3</b>	<b>1</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>4</b>
Compliance with Section 803(a) of the Federal Financial Management Improvement Act (FFMIA)						
	Agency		Auditor			
1. Federal Financial Management System Requirements	Lack of compliance noted		Lack of compliance noted			
2. Applicable Federal Accounting Standards	Lack of compliance noted		Lack of compliance noted			
3. USSGL at Transaction Level	Lack of compliance noted		Lack of compliance noted			

## PAYMENT INTEGRITY

Since enactment of the Improper Payments Information Act of 2002 (IPIA), the Office of Management and Budget (OMB) has worked with agencies to increase the number of accurate federal payments. The IPIA, as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA), and the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA), require agencies to annually report information on improper payments to the President and Congress. IPERIA also updates the definition of what is considered a “significant improper payment.” Significant improper payments are defined as gross annual improper payments in a program exceeding 1.5% and \$10 million of total program funding, or \$100 million in improper payments regardless of the improper payment percentage. The USMC provides the following information on payment integrity and improper payment reporting details in accordance with IPERIA, OMB Circular No. A-123, Appendix C, *Requirements for Effective Estimation and Remediation of Improper Payments*, and OMB Circular No. A-136, *Financial Reporting Requirements*.

USMC’s improper payment information is captured at the combined Department of Defense (DoD) level at <https://paymentaccuracy.gov/>. The website contains: 1) current and historical rates and amounts of improper payments; 2) an understanding of why improper payments occur; and 3) an indication as to what agencies are doing to reduce and recover improper payments. The disclosures made in this section are as of August 31, 2017.

### Payment Reporting

For the Defense Travel System (DTS), USMC performed a risk assessment during FY 2017 and determined that it is susceptible to significant improper payments at or above the thresholds established by OMB. Typically, the risk assessment is performed each fiscal year by the Defense Finance and Accounting Services (DFAS) for each military service and other DoD agencies.

The DTS risk assessment uses established criteria contained in OMB Circular No. A-123, Appendix C. DFAS monitors changes in programs associated with OMB-mandated criteria (for example, a large increase in annual outlays, regulatory changes, or newly-established programs) to identify unfavorable trends and allow for early implementation of corrective actions.

In addition, the U.S. Department of the Navy’s (DON) Office of Financial Operations is updating guidance to reflect recent changes as a result of IPIA amendments (IPERA and IPERIA) and updates to OMB Circular No. A-123, Appendix C. Communicating updated guidance to stakeholders such as USMC will be accompanied by a more formal program governance structure, including the establishment of a program office and formal appointment of a component senior accountable official, demonstrating the DON’s commitment to good stewardship of taxpayer dollars and reminding appointing officials of their duty to hold accountable those responsible for certifying payments.

The USMC has reinforced emphasis on reducing improper payments through revised monthly vice quarterly Marine Corps Administrative Analysis (MCAAT) audits, increased training for voucher Approving Officials (AO), and a draft re-write of the Marine Corps order which will require formal certification for all AOs.

### DTS Root Causes

The primary reason for DTS improper payments is voucher input errors by travelers. In addition, AOs’ failure to identify errors prior to authorizing reimbursement contributed to improper payments from an internal control perspective. Moreover, the errors identified in the sample can be reported as administrative errors or errors that may result in an actual loss of funds to the government. The administrative errors include missing or invalid receipts (as defined in the Joint Travel Regulations) or omission of required elements (e.g. dates and/or signatures).

## Administrative Errors

- Receipts: Failure to attach receipts to the travel voucher, invalid or incorrect receipts, and illegible receipts
- Vouchers: Incomplete voucher, missing data, information does not match voucher

Other monetary errors that may result in an actual loss of funds.

- Meals & Flat Rate Per Diem: Failure to properly pay flat rate per diem (partial per diem) once a member is on temporary duty for 31 or more days
- Lodging: The attached receipt for lodging does not reflect the same amount claimed on the travel voucher

## Corrective Actions

The USMC corrective action plan to reduce improper payments caused by the agency administrative or process errors includes the following efforts:

- Conducted training in areas of deficiencies (e.g. required documentation needed for proper payment, proper computation of entitlements)
- Coordination/training with DFAS on error definition

## Payment Recapture Audits

Based on the low rate of improper payments, USMC concluded that the cost of executing a separate payment recapture audit program outweighs the benefits of finding and recovering erroneous payments by the disbursing and finance offices themselves, which is the current practice. The staff resources needed to conduct such a program, sustain the contract, and oversee such a recapture program would be significant and provide minimal to no benefit to the government. Accordingly, the USMC has not performed any recapture audits or payment recapture programs. The USMC does not report recaptured amounts and amounts recovered through sources other than payment recapture audits.

## Barriers

Based on the statutory threshold, USMC does not have any regulatory barriers that would limit any corrective actions in reducing improper payments.

## Accountability

In order to reduce and recapture improper payments, the USMC disbursing and finance offices, accountable officials, and travel clerks are required to scrutinize payment requests prior to approving the disbursement of funds.

## Information Systems and Other Infrastructure

The following table summarizes DFAS/USMC's results of the DTS risk assessment by component of internal control as defined by the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government*:

Component of Internal Control	DTS
Control Environment	4
Risk Assessment	4
Control Activities	4
Information and Communication	4
Monitoring	4

### Definitions:

- 1 = Controls are not in place to prevent improper payments
- 2 = Minimal controls are in place to prevent improper payments.
- 3 = Controls are in place to prevent improper payments, but there is room for improvement.
- 4 = Sufficient controls are in place to prevent improper payments.

USMC has an adequate system of internal controls to assist in minimizing/reducing improper payments such as the MCAAT team's audit analysis and each disbursing offices' and finance offices' internal control reviews designed to detect and prevent improper payments. USMC's improper payments percentage may be further reduced by ensuring all travel claims contain the proper substantiating documents for a proper payment which has been enhanced by the DTS's recent system receipts requirement for specific expenses. DTS improper payments for USMC were at 3.14% for FY 2017, well below the FY 2017 DoD goal of 4.46%.

## Sampling and Estimation

DFAS uses statistically valid sampling methods designed to meet or exceed OMB's requirements of a 90 percent confidence level and a margin of error of  $\pm 2.5$  percent. By using these methods, DFAS and USMC are able to identify valid sample sizes and project improper payment percentages for the improper payment program. In FY 2018, DFAS will continue to address previous GAO recommendations by further updating its sampling plan for Travel Pay, changing to a methodology that stratifies the populations by the dollar amount of the payment.

USMC's sampling plan is a stratified simple random sample with variable design, stratified by dollar, and utilizes the Neyman Allocation method for appropriate allocation of sample sizes for each dollar stratum. The sampling plan defines the populations of wide-range dollar payment amounts from which the quarterly samples are randomly selected and reviewed. The sampling plan exceeds OMB's statistical probability and precision standards. Improper payment estimates are calculated from the errors found during quarterly reviews for travel payments. The estimation process gives both an estimate and confidence interval for the error rate and the dollar amount of improper payments.

## FRAUD REDUCTION REPORT

OMB Circular No. A-136 requires that, "Under the Fraud Reduction and Data Analytics Act of 2015 (Pub. L. 114-186, 31 USC 3321 note), each agency must include in its Agency Financial Report or Performance and Accountability Reports a report on its fraud reduction efforts undertaken in FY 2017 and the final quarter of FY 2016." While USMC has begun to embark upon a process by which it will identify and undertake fraud reduction efforts, USMC has not performed fraud reduction efforts during the stated timeframe.

## REDUCE THE FOOTPRINT

USMC, under DON, has adopted the principles of the published *National Strategy for the Efficient Use of Real Property (2015-2020)*, *Reducing the Federal Portfolio through Improved Space Utilization, Consolidation and Disposal* as well as the requirement to freeze and reduce the footprint. The DON combines the United States Navy and the USMC under the civilian oversight and leadership provided by the Secretary of the Navy (SECNAV) for goals, objectives, compliance, and reporting purposes when responding to the Secretary of Defense (SECDEF). The DON produces a consolidated Navy and USMC Plan, titled *Real Property Efficiency Plan, Reduce the Footprint Policy Implementation* to the SECDEF, to support the published *Department of Defense Real Property Efficiency Plan, Reduce the Footprint Policy Implementation* submitted to the OMB.

The DON has several strategies in place to reduce its footprint and increase the efficient use of real property. The SECNAV policy authorizes acquisition of property by lease only when needed to meet an approved military requirement and there is no other DoD or federal real property available that can adequately support the approved military requirement. The DON employs an installation planning process for the USMC using the Marine Corps Facilities Planning and Programming System enabling an evaluation and validation of the mission's Basic Facilities Requirement. Requirements are reconciled with all other existing assets before considering an increase to the footprint. The checks and balances process controls the USMC's real estate portfolio. The DON evaluates demolition and consolidation plans annually, forecasting potential projects, and seeks to execute projects identified as having the best return on investment. This strategy, too, seeks to balance the portfolio in accordance with expenditures and capital investments. Infrastructure investments and divestments are balanced in consideration with emerging missions, weapons system acquisitions,



geopolitical changes, mandated relocations, and the requirements and logistics of moving equipment and personnel against a receiving location's existing assets. Once strategic decisions are made to locate forces and capabilities in a particular geographic area to meet military operation plans, USMC looks at force capability requirements and identifies existing infrastructure capacity. This process attempts to achieve the best, most effective, and least costly solution to meet the requirements while minimizing impacts to force readiness.

The USMC Commandant's recent initiative, entitled Infrastructure Reset (IR) Strategy, signed during FY 2017, initiates a long-term effort to restructure current lifecycle management with an objective to aggressively drive down infrastructure costs to sustainable levels, while continuing to support current and future missions. Implementation of IR consolidates and right-sizes the infrastructure footprint within existing installations to improve operational readiness, aggressively eliminating failing facilities. IR Strategy success requires upfront investment in facilities planning, space management tools, and demolition; however, returns on investment in reduced sustainment and management costs are expected. The investment offsets over the execution period and beyond through reduced facility maintenance, utilities, and services as USMC consolidates and demolishes failing and excess facilities, effectively reduces the real property inventory. Implementation requires demolition of failing facilities, investment for properly sustaining facilities retained, recapitalization of those with beyond life capacities, and modernization or construction of new facilities to support oncoming and evolving missions. Necessary resources are expected to be released to support the installations' capable platforms ready to launch Marine Forces. The Strategy expects to demolish ~31 million square feet of facilities over the next 10 years, generating future annual cost avoidance. First Priority consolidation and divestiture plans are placed on vacant and failing facilities slated for demolition by fiscal year 2022.

#### REDUCE THE FOOTPRINT POLICY BASELINE COMPARISON

	FY 2015 Baseline	FY 2016 (CY-1)	Change (FY 2015) Baseline to FY 2016)
Square Footage (SF in thousands)	32,330	32,080	(250)

#### REPORTING OF O&M COSTS – OWNED AND DIRECT LEASE BUILDINGS

	FY 2015 Reported Cost	FY 2016 (CY-1)	Change (FY 2015) Baseline to FY 2016)
Operation and Maintenance Costs** (\$ in thousands)	\$103,140	\$99,020	(\$4,120)

*\*\*These costs are based on an estimate.*

## Acronyms

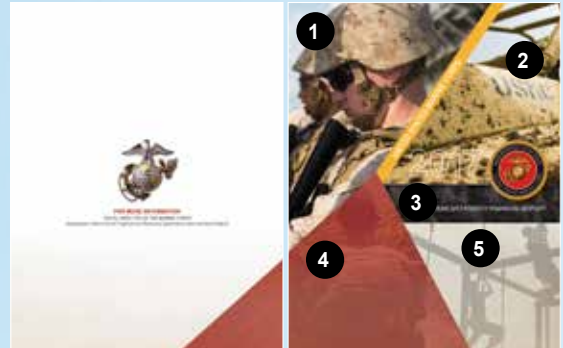
ACRONYM	DEFINITION
<b>AAV</b>	Assault Amphibious Vehicle
<b>ACD&amp;P</b>	Advanced Component Development and Prototypes
<b>ACV</b>	Amphibious Combat Vehicle
<b>ADL</b>	Administrative Deadline Programs
<b>AFRICOM</b>	U.S. Africa Command
<b>AO</b>	Approving Officials
<b>APSR</b>	Accountable Property System of Record
<b>ASP</b>	Administrative Storage Programs
<b>BA</b>	Budget Activities
<b>BRAC</b>	Base Realignment and Closure
<b>CAA</b>	Clean Air Act
<b>CENTCOM</b>	U.S. Central Command
<b>CFO</b>	Chief Financial Officer
<b>CIP</b>	Construction in Progress
<b>CMC</b>	Commandant of the Marine Corps
<b>CSRS</b>	Civil Service Retirement System
<b>CWA</b>	Clean Water Act
<b>CYBERCOM</b>	U.S. Cyber Command
<b>DDRS</b>	Defense Departmental Reporting System
<b>DERP</b>	Defense Environmental Restoration Program
<b>DFAS</b>	Defense Finance and Accounting Services
<b>DHA</b>	Defense Health Agency
<b>DLA</b>	Defense Logistics Agency
<b>DM&amp;R</b>	Deferred Maintenance and Repairs
<b>DoD</b>	U.S. Department of Defense
<b>DOL</b>	Department of Labor
<b>DON</b>	U.S. Department of the Navy
<b>DONHAMS</b>	DON Heritage Assets Management System
<b>DOT</b>	Department of Transportation
<b>D-PRV</b>	Deflated Plant Replacement Value
<b>DTS</b>	Defense Travel System
<b>ELMP</b>	Enterprise Life Cycle Maintenance Program
<b>EOU</b>	Excess, Obsolete, or Unserviceable
<b>ERM</b>	Enterprise Risk Management
<b>EUCOM</b>	U.S. European Command
<b>FASAB</b>	Federal Accounting Standards Advisory Board
<b>FBWT</b>	Fund Balance with Treasury
<b>FCI</b>	Facilities Condition Index
<b>FECA</b>	Federal Employees' Compensation Act
<b>FERS</b>	Federal Employees Retirement System
<b>FFMIA</b>	Federal Financial Management Improvement Act
<b>FISCAM</b>	Federal Information System Controls Audit Manual
<b>FMFIA</b>	Federal Managers' Financial Integrity Act

ACRONYM	DEFINITION
<b>FYE</b>	Fiscal Year End
<b>GAAP</b>	Generally Accepted Accounting Principles
<b>GAO</b>	Government Accountability Office
<b>G/ATOR</b>	Ground/Air Task Oriented Radar
<b>GBAD</b>	Ground Based Air Defense
<b>GCSS-MC</b>	Global Combat Support System, Marine Corps
<b>GE</b>	General Equipment
<b>GMRA</b>	Government Management Reform Act
<b>GPP&amp;E</b>	General Property, Plant, and Equipment
<b>HQMC</b>	Headquarters, U.S. Marine Corps
<b>IMA</b>	Intermediate Maintenance Activity
<b>IPAC</b>	Intragovernmental Payment and Collection
<b>IPERA</b>	Improper Payments Elimination and Recovery Act
<b>IPERIA</b>	Improper Payments Elimination and Recovery Improvement Act
<b>IPIA</b>	Improper Payments Information Act
<b>IPT</b>	Integrated Project Team
<b>IR</b>	Infrastructure Reset
<b>IT</b>	Information Technology
<b>IUS</b>	Internal Use Software
<b>LAC</b>	Latest Acquisition Cost
<b>M&amp;R</b>	Maintenance and Repair
<b>MAGTF</b>	Marine Air-Ground Task Force
<b>MARCENT</b>	Marine Corps Forces Central Command
<b>MARFORCOM</b>	U.S. Marine Corps Forces Command
<b>MARFORCYBER</b>	Marine Corps Forces Cyberspace Command
<b>MARFORK</b>	USMC Forces Korea
<b>MARFORPAC</b>	U.S. Marine Corps Forces, Pacific
<b>MARFORRES</b>	U.S. Marine Corps Forces Reserve
<b>MARFORSOUTH</b>	Marine Corps Forces South
<b>MARFORSTRAT</b>	Marine Corps Forces Strategic Command
<b>MARSOC</b>	U.S. Marine Corps Forces, Special Operations Command
<b>MCAAT</b>	Marine Corps Administrative Analysis
<b>MCEITS</b>	Marine Corps Enterprise IT Services
<b>MCESG</b>	Marine Corps Embassy Security Group
<b>MCICOM</b>	Marine Corps Installations Command
<b>MCLC</b>	Marine Corps Logistics Command
<b>MCOTEA</b>	Marine Corps Operational Test & Evaluation Activity
<b>MCSC</b>	Marine Corps Systems Command
<b>MCSFR</b>	USMC Security Force Regiment
<b>ME</b>	Military Equipment
<b>MEF</b>	Marine Expeditionary Forces
<b>MERHCF</b>	Medicare-Eligible Retiree Health Care Fund

ACRONYM	DEFINITION
<b>MICP</b>	Managers' Internal Control Program
<b>MILSTRIP</b>	Military Standard Requisitioning and Issue Procedure
<b>MOCAS</b>	Mechanization of Contract Administration Services
<b>MRP</b>	Materiels Returns Program
<b>NAVAIR</b>	Naval Air Systems Command
<b>NAVFAC</b>	Naval Facilities Engineering Command
<b>NORTHCOM</b>	U.S. Northern Command
<b>OEL</b>	Other Environmental Liabilities
<b>OGC</b>	Office of General Counsel
<b>OM&amp;S</b>	Operating Material and Supplies
<b>OMB</b>	Office of Management and Budget
<b>OPM</b>	Office of Personnel Management
<b>OUSD</b>	Office of the Under Secretary of Defense
<b>PISD</b>	Placed in Service Date
<b>PMCS</b>	Preventive maintenance, checks and services
<b>PRV</b>	Plant Replacement Value
<b>RCRA</b>	Resource Conservation and Recovery Act
<b>RDT&amp;E</b>	Research, Development, Test, and Evaluation

ACRONYM	DEFINITION
<b>ROK</b>	Republic of Korea
<b>SBR</b>	Statement of Budgetary Resources
<b>SCNP</b>	Statement of Changes in Net Position
<b>SDD</b>	System Development and Demonstration
<b>SDP</b>	Savings Deposit Program
<b>SDWA</b>	Safe Drinking Water Act
<b>SECDEF</b>	Secretary of Defense
<b>SECNAV</b>	Secretary of the Navy
<b>SFFAS</b>	Statement of Federal Financial Accounting Standard
<b>SNC</b>	Statement of Net Cost
<b>SOUTHCOM</b>	U.S. Southern Command
<b>STRATCOM</b>	U.S. Strategic Command
<b>TSP</b>	Thrift Savings Program
<b>UNC</b>	United Nations Command
<b>USFK</b>	U.S. Forces Korea
<b>USMC</b>	United States Marine Corps
<b>USPACOM</b>	U.S. Pacific Command
<b>USSGL</b>	U.S. Standard General Ledger
<b>USSOCOM</b>	U.S. Special Operations Command
<b>VSIP</b>	Voluntary Separation Incentive Pay
<b>WCF</b>	Working Capital Fund





## PHOTO CAPTIONS

1. Marines with mark impact holes on a target after conducting a live-fire drill range. (U.S. Marine Corps photo by Cpl. April Price)
2. Marines utilize the Utility Task Vehicle and explore its capabilities. The UTV is the most recent advancement in the capabilities and mobility of marines. (U.S. Marine Corps photo by Lance Cpl. Caleb Maher)
3. Marines and Sailors of an Expeditionary Strike Group joined together to honor fallen Marines during a sunset memorial. (U.S. Marine Corps photo by Lance Cpl. Amy Phan/Released)
4. Conducting a patrol with medical evacuations and assaulted enemy villages during a training iteration. (U.S. Marine Corps photo by Lance Cpl. Joshua Pinkney)
5. U.S. Marine Corps recruits climb ropes during an obstacle course on Marine Corps Recruit Depot, Parris Island, S.C. (U.S. Marine Corps photo by Lance Cpl. Colby Cooper)





**FOR MORE INFORMATION**

***FISCAL DIRECTOR OF THE MARINE CORPS***

Headquarters, Marine Corps Programs and Resources Department: [hqmc.marines.mil/pandr/](http://hqmc.marines.mil/pandr/)